Canada. Task force on the structure of Canadian industry
Study
Direct investment abroad by firms located in Canada, by Timothy E. Reid

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The recommendations contained herein grew out of the specific topic of the paper. They do not necessarily represent the recommendations that will be made by the author or by the Task Force regarding the overall topic of foreign investment once all the memoranda have been considered.

Canada

A study prepared for the Task Force on the Structure of Canadian Industry

September 1967.

CONFIDENTIAL AUGUST 31, 1967.

Distribution to the Task Force on the Structure of Canadian Industry
Privy Council Office
Government of Canada.

Not for publication

PREFACE

This is a report for the Task Force on the Structure of Canadian Industry. This report has too many limitations to list in detail. To believe that one could say very much of significance on a subject as unexplored, broad and complicated as Canadian Direct Investment Abroad (CDIA) after two and a half months of full-time attention, is folly. If this report does no more than draw attention to the fact that very little is known about CDIA, that the finding out of anything really worthwhile about CDIA would take a research team at least a year, that there are very complex anomalies surrounding the concept of CDIA, and that in certain areas there may be a fundamental insurmountable research impasse because of the possibly heavy interdependency of the research methodology used and the results obtained -- if this report does a few of these things, then it may have been a worthwhile expenditure of time and resources.

A number of people have contributed to the content of this report. Very little could have been said about Canadian Direct Investment Abroad without the closest possible consultation with Mr. E. B. Carty and his assistant, Mr. David Buxton at DBS. Both these gentlemen had severe constraints placed on them by the Statistics Act in terms of the information they could make available to an outside researcher. While these legal constraints often seemed unnecessary and proved frustrating to this outside researcher, the generous hospitality of Mr. Carty and Mr. Buxton served to make the realities of the Statistics Act slightly more palatable.

This report could not have been prepared even in its present highly "survey" form without the capable assistance of Mr. Ken Dancyger and Mr. Richard Schultz, the two research assistants associated full-time with the project. Nor could the report have been completed without the stenographic skills of Miss Lillian Verral.

This report is not in publishable form: the calculations in the statistical appendix upon which the summary tables in the text of the report are based, have not been recalculated to check against errors; some essential footnotes are missing both on grounds of the limitations of time and because of agreed upon non-attribution. Above all, this report is knowingly speculative and such speculation has not been thoroughly tested with others who have accumulative wisdom in specific areas. The author is quite willing to revise this report for publication (with the necessary deletions) by January 1st, 1968.

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DIRECT INVESTMENT ABROAD BY FIRMS LOCATED IN CANADA
(Canadian Direct Investment Abroad, CDIA)

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Definitional Note

In this report the DBS definition of direct investment is used, unless otherwise noted. Canadian Direct Investment Abroad (CDIA) includes that investment in enterprises abroad by firms located in Canada in which those firms are known to have 50 per cent or more of the voting stock of enterprises outside Canada. Some other enterprises abroad are included in which firms located in Canada have less than 50 per cent of the voting stock: DBS includes such investment in its calculations of CDIA on the grounds that "effective control" is held by the Canadian located firm over the foreign enterprise.

An attempt has been made in this report to distinguish CDIA ownership and "control" over the decision-making of a foreign enterprise by a firm located in Canada which owns a proportion of the voting stock of a foreign enterprise. The concept of "control" is further modified where possible into "potential control" and "exercised control".

CHAPTER 1

PURPOSE OF THE STUDY

I

The general purpose of the study is to examine direct investment abroad by firms located in Canada. The study itself is part of a broader study on the structure of Canadian industry that emphasizes foreign direct investment in Canada. To a considerable extent Canadian direct investment abroad (CDIA) is the reverse of foreign direct investment in Canada (FDIC), and accordingly many of the questions that can be asked about FDIC can also be asked about CDIA. A few of these questions have been raised in this report. While an attempt has been made to integrate the answers to these questions, the report does not have a sharp or single focus.

II

The conceptual problems and limitations surrounding an analysis of FDIC also surround a similar analysis of CDIA. Some of these problems and limitations depend upon the questions which are asked. What is the most relevant definition of direct investment in terms of such questions? What are the limitations of the present definitions used to calculate official DBS series? What is the significance of classifying direct investment as non-resident and resident owned and/or "controlled"? In addition to owning a proportion of a firm's equity, what techniques for controlling or influencing decision-making within a firm with international operations are possible (monopoly, monopsony)? Where is the line between "control" of decision-making and "influence" over decision-making within the firm? One purpose of this report is to discuss such conceptual problems with respect to CDIA.

III

There is also a purely descriptive purpose at both the macro and micro level. What is the size of CDIA in terms of various measures? What is the geographical distribution abroad of such investment and what changes have taken place over time? What is the industrial composition of CDIA and what changes have taken place over time? To what extent is CDIA owned and "controlled" by a few firms in Canada and what changes in the degree of concentration have taken place over time? What is the degree of non-resident equity in, and control of, CDIA and what changes have taken place over time? What is the size of dividend receipts over time?

At the micro level there are also purely descriptive questions, particularly pertaining to the 18 firms for which profiles have been done. For example, what are some of the characteristics of firms engaged in CDIA?

In this report, the degree of systematic integration of the macro and micro data and information is not as great as it would have been if a further month of research time had been available. Similarly with the degree of integration of macro and micro analysis. The validity of such integration would have been greater if time had permitted the completion of the 33 firm profiles as originally intended rather than the 18 which were actually completed.

IV

Another purpose is to offer possible explanations for CDIA having arisen and for changes in its relative geographical distribution, industrial detail, etc. The explanations offered will be based both on general theory and on the 18 firm profiles. Why have firms undertaken CDIA? Is there any evidence of a common reason, or is it specific? Why have they chosen CDIA to generate external revenue rather than relying on greater exports, licensing arrangements, purchases of foreign portfolio securities, etc.? Why is not more or less CDIA? Why have they chosen particular countries for their direct investments?

V

Another purpose is to examine some of the relationships between CDIA and Canadian Federal Government policy. For example, what is the

policy, if any, of the Federal Government concerning the accumulation of CDIA in foreign countries and specifically the flow from Canada of direct investment to foreign countries?

Are there any national objectives concerning CDIA? If there are national objectives, do firms located in Canada assist in achieving those objectives? Or, postulating possible national objectives concerning CDIA, what specific Government policies could be employed to assure that CDIA firms assist in achieving those national objectives? Moreover, specifically with regard to external consequences, how might the U.S. Federal Government (in particular) react to various Canadian national objectives pertaining to CDIA? And finally, should the Canadian Federal Government have a policy with respect to CDIA?

VI

Another purpose is to raise questions about the internal decision-making of CDIA firms. What information about a CDIA firm is necessary before an analysis can be attempted concerning the decision-making process and relationships between parent companies in Canada and their wholly-owned or partially-owned enterprises abroad, for example, decision-making regarding capital expansion, market access and market sharing, pricing of goods and services exchanged between parent and subsidiary? (What are the diverse research methods and strategies that could be used to generate such internally sensitive information and how reliable are these diverse research methods? To what extent does the selection of a particular research method determine the conclusions that are generated by using that method?) Does the resident and non-resident ownership characteristic of CDIA firms explain anything about any observed variation in the performance of such firms or do other characteristics offer better explanations (nature of the industry within which a CDIA firm operates)? A special Appendix on the question of decision-making within a direct investment firm has been prepared.

VII

Another purpose of the study is to touch on the question of whether or not CDIA enterprises are judged by their host nations to be good or bad "corporate citizens". What are the definitions of "corporate citizenship"? What are the criteria for evaluating this citizenship?

VIII

It was expected from the outset that the content of original research in this 2-1/2 month study would be minimal. Time and resources precluded anything more than a pulling together of the scattered material on CDIA in some reasonably ordered way, as well as an exploitation of existing information to arrive at a few speculative conclusions.

Chapter 2

Summary of Some of the Conclusions

Economic Costs and Benefits to Canada of CDIA

1. It is impossible in this study to arrive at a net economic cost or net economic benefit figure to Canada of the present level of CDIA assets (and the annual increments in those assets). A rigorous evaluation of this aspect of CDIA would have to be most specific in terms of the short run and long run time-horizons used to arrive at a quantitative conclusion. Also, the assumptions relating to indirect economic effects would have to be made explicit. Also, economic growth *per se* may only be one of several economic objectives of Canada. These are but three of these factors which would have to be carefully taken into account.

2. It is doubtful that economic costs and benefits to Canada can be calculated solely from an examination of existing aggregate statistics on CDIA. From the 18 Firm Profiles completed in this report, it would appear that the total economic costs and benefits of CDIA having arisen should be built up from depth case studies on both the firms engaged in CDIA and firms engaged in substitute activities which result in foreign earnings: it would seem necessary to calculate, at the micro level, the opportunity cost of CDIA not only in terms of less investment in Canada but also in terms of exports, licensing revenue, portfolio investment, which are the direct substitute means of generating foreign earnings.

3. Some examples of why a built-up micro approach would appear to be the most productive approach to this question may be helpful. Cominco has a 45 per cent ownership interest in Mitsubishi Cominco Smelting Company Ltd. of Japan, which purchases lead concentrates from the Pine Point Mines Ltd. in the Northwest Territories (69 per cent owned by Cominco). It is tempting to conclude that these exports of lead concentrates from Canada are an economic benefit to Canada which resulted from this specific CDIA by Cominco (assuming 45 per cent ownership is classified as CDIA rather than portfolio investment, a conceptual question which also has an important bearing on the economic costs and benefits aspect of CDIA). However, some increase in exports from Pine Point to Japan might well have taken place without Cominco getting involved via direct investment in Japan. Therefore, in calculating the economic benefit to Canada of Cominco's direct-investment, induced exports would have to be netted out. Furthermore, it could be argued that Cominco could have used the investment resources in Canada for production facilities and purchased lead concentrates from Pine Point and then exported a proportion of the increased output. Whether or not the economic benefits to Canada of an alternative use of the investment resources that went to Japan would have been greater than the direct investment used, would have to be calculated in great detail on explicit assumption. Alcan has direct investment in bauxite mines in Guyana, Jamaica, France and the Malay Peninsula. It is an import creating kind of direct investment which some balance-of-payments economists might consider an economic cost to Canada in certain situations. Yet production of manufactured products in Canada might be less without these direct-investment bauxite mines abroad. On the other hand, techniques other than direct investment might have resulted in reliable sources of bauxite (portfolio investment, long-term import contracts, etc.) which might have entailed less capital outflow from Canada. These few aspects of CDIA would have to be carefully considered in an attempt to calculate the economic costs and benefits of Alcan's activities outside Canada.

4. The question of possible greater taxation revenue accruing to the Canadian Government from an alternative use of CDIA funds in Canada is another aspect of the cost and benefit question. Specific relative disincentive policies on the flow of direct investment funds abroad vis-a-vis investment in Canada might not result in greater Government revenue (see Chapter 12(c)).

5. The flow of Canadian entrepreneurship abroad in association with CDIA is another important aspect of the economic cost and benefit to Canada question, particularly if it is assumed that this is a relatively scarce factor of production in Canada. It could be argued that these entrepreneurs are underemployed in Canada because of lack of opportunities, whereas they are fully employed abroad. Such questions would have to be explored in depth.

6. The question of foreign ownership and potential/realized "control" of CDIA would have to be analysed in depth to judge the extent to which such ownership and control affects the economic costs and benefits of CDIA to Canada.

7. The question of the reaction of foreign governments (as well as foreign businessmen) to a change in Canada's "non-policy" regarding CDIA would also have to be considered (see Chapter 12(a)).

8. These are but a few of the questions that would have to be raised in a thorough research study on the economic costs and benefits of CDIA to Canada. Such an objective is not an objective of the present study. A judgment on whether or not, from the economic point of view, Canada should have more or less CDIA would depend on the results of such a study.

Research Methods and Limitations

1. What research that has previously been done on CDIA has been primarily as an aspect of a broader subject, for example, the Canadian Balance of Payments. CDIA does not appear to have been studied as an integrated area of economic and political activity.

2. CDIA firms in Canada were most co-operative in supplying publicly available information directly to this project to facilitate research. Most of their subsidiaries abroad referred requests for information pertaining to their operations to their respective head offices.

3. The Statistics Act severely restricted DBS from supplying outside researchers with essential information.

4. In conjunction with #3 above, the short research period for the completion of this report prevented proper sampling from the total population of CDIA firms for selected firm profiles. Consequently, generalizations from the selected firms concerning the total population of CDIA firms are open to serious doubts.

5. The short research period plus a serious methodological difficulty, did not allow an analysis of decision-making behavior of CDIA to be accomplished.

6. No attempt was made to formally correlate the aggregate statistics pertaining to CDIA and other possibly related statistics.

7. The research approach used in this report is an ad hoc approach; it could better be described as a survey of existing publicly available data and information - a gathering together in one place of what is available and sorting it out in some useful way.

8. The conclusions are often highly speculative: more must not be made of them than the research methods will allow.

Conceptual Problems and Limitations

1. There are several conceptual problems and limitations surrounding an analysis of foreign direct investment. One such question has to do with the reasons for changes over time of the value of CDIA assets, their geographical distribution, etc. Statistical reclassification between portfolio investment and CDIA, for example, could account for a large part of such changes along with new CDIA flows from Canada.

2. Another central question is the relationship between a statistical definition of "control" based on ownership of equity and realized behavioral control of decision-making over a foreign enterprise (which may exist with a minimal level of equity ownership). The distinctions between "potential control", "realized control", and "controlling influence" also are difficult to make.

Aggregate Statistics

1. Between 1954 and 1964, CDIA assets grew at a more rapid rate than total long term external assets and gross external assets.

2. Between 1954 and 1964, the rapid growth of industrial/commercial (excl. beverages) CDIA assets was the most significant factor in the growth of total CDIA assets. Such assets increased their percentage share of total CDIA assets from 31 percent in 1954 to 41 percent in 1964.

3. Between 1954 and 1964, the growth of CDIA assets in the U.S. was much less than in the R.O.W. The U.S. relative share of CDIA assets decreased from 76 percent in 1954 to 60 percent in 1964. There is evidence to suggest that if the definition of CDIA were changed to say a 35 percent rather than 50 percent ownership level (with a few special cases), the U.S. share might be substantially less.

4. In every industrial classification used by DBS there was a relative shift away from the U.S. to the R.O.W. (except in railways which are located completely in the U.S.).

5. The ratio of CDIA assets to FDIC assets declined from 23.5 percent in 1954 to 21.4 percent in 1964. The ratio in 1926 was 22.2 percent.

6. For the eleven year period, 1954-1964, accumulated dividend receipts on CDIA equalled accumulated CDIA outflows from Canada.

7. In 1963 the 13 largest firms (in terms of their book-value of CDIA) accounted for 70.3 percent of total CDIA assets. The next 8 largest firms accounted for an additional 7.2 percent. The next 38 largest firms accounted for an additional 11.5 percent. The remaining smaller firms (probably 300-350 firms) accounted for the residual (11.0 percent). Thus, a total of 21 firms accounted for almost 78 percent of total CDIA and 59 firms for 89 percent of the total. Whether or not there has been a significant change in the "domestic" concentration of control of CDIA since 1954 is difficult to judge.

8. Non-resident ownership of CDIA equity increased from 37 percent in 1954 to 47 percent in 1964. This change does not necessarily mean that foreign <u>citizens</u> increased their relative share.

9. Non-residents "controlled" 27 percent of CDIA in 1954 and 43 percent in 1964. This change does not necessarily mean that foreign <u>citizens</u> increased their relative share.

Characteristics of 18 Firms Engaged in CDIA

1. There is a marked preference among the firms studied to locate in well-established politically stable areas such as the United States and Europe.

2. The "international" firm such as Alcan or Massey-Ferguson is more likely to have CDIA than a "national" firm such as Fraser Companies Ltd.

3. There has been a marked relative shift away from U.S. investment by firms such as Alcan, which are investing relatively more in Oceania and the Caribbean than in North America, and Polymer which is in Europe.

4. Vertical integration as in the case of Alcan or Distillers Corporation-Seagrams Ltd., is a prominent motive for CDIA.

5. A hypothesis which could be tested in a more detailed study is: are non-resident firms such as George Weston Ltd. more likely to indulge in CDIA than resident corporations such as The Dominion Stores?

Why Firms have Engaged in CDIA and their Choices between CDIA and their Choices between CDIA, Exports, Licensing and Portfolio Investment

1. The desire to gain maximum reliability and a continuing source of a factor input, i.e., bauxite for the production of aluminum, is fulfilled when the parent company has as much "control" of the subsidiary as is possible.

2. Import restrictions by some countries make direct investment the only way to gain access to the market of that country. An example is Distillers Corporation-Seagrams Limited who established a plant in Mexico to produce rum (its import is prohibited by the government).

3. Tariffs may negate the competitive advantage of exports and necessitate CDIA if the parent firm wants to continue its expansion, i.e., Polymer. (This is especially true of firms that are already well established in their domestic market as anti-monopolistic legislation and stiff competition obviate the firms chances for domestic expansion.)

4. To maintain its sales level in a particular country, Polymer established subsidiary companies within the Common Market.

5. Licensing is not an alternative for many firms unless the firm has a specialty in processing or products that are patented or carry trademarks.

6. Government policy in certain countries, such as Japan and Sweden, precludes the establishment of CDIA and promotes joint ventures and associated companies.

7. Insufficient capital or extensive capital losses may lead from CDIA to licensing as in the case of Harvey Woods.

8. Desire for regional vertical integration leads Alcan to CDIA. Bauxite mined in France is shipped to European subsidiaries for production of aluminum products.

9. Distillers Corporation-Seagrams Ltd. prefers direct investment to other forms of foreign investment because it can maintain control over the quality of its product, i.e., to maintain its reputation for quality.

10. Moore Corporation prefers direct investment to other forms of foreign investment because it allows them to maintain their policy of industrial secrecy and to protect their technical advantages over their competitors.

Why Some Firms Have Chosen Particular Countries for CDIA

1. A company may locate in the United States because of its proximity, as in the case of Consumers Gas. The availability of a large market for its product, attracts other firms such as Distillers Corporation-Seagrams Limited. The desire to achieve vertical integration within its American or overall operation appears to be the case of Moore Corporation. Avoidance of the American tariff may often be the reason for location in the United States, for example, the Fraser Company. Utilities, pipelines and railways have direct investment in the United States because it may provide the shortest route, i.e., the most economical, or to attract some American business to Canada.

2. Location in Latin America and the Caribbean area often takes place because of the national resources of those countries, and in some cases, the growing purchasing power of those countries. For example, Alcan Aluminum locates in Jamaica, in mining bauxite, a raw material that is the basis of its production of aluminum. This type of investment appears to be an integral part of the firm's policy of vertical integration, as may be the establishment of plants to manufacture aluminum products in Uruguay. Similarly, Distillers Corporation-Seagrams Limited has plants throughout South America and Mexico, to produce liquor for the home market as well as to produce domestic liquor such as rum, for export to other markets such as Europe, the United States and Canada.

3. Moore Corporation appears to locate abroad so that it may dominate that domestic market when such a market develops, i.e., in South America. The importance of external tariffs against imports of manufactured goods such as business forms, has played a significant role in making the decision to invest in a country such as El Salvador.

4. Low labour costs and tax concessions such as accelerated depreciation may have attracted Salada Foods to produce Jello in Jamaica. Exchange rate difficulties are, in this way avoided, on sales within the sterling area.

5. An important reason for direct investment in Europe is the existence of the European Common Market. In order to avoid its outer tariff, such companies as Polymer may have located in France and Belgium. The political stability of these European countries, reduces the risk involved in such investments compared to other countries.

6. The existence and size of tariffs seem to have a strong influence on the foreign investment decision. One wonders how significant an effect the new Kennedy Round tariff cuts will have on direct investment. Will these tariffs decrease sufficiently so that it will no longer be economical to continue direct investment as opposed to exports?

Changes Over Time in Intra-Firm Relations

Insufficient information was available to make any conclusions concerning changes over time in the intra-firm decision-making relationships and the relative importance of the parent company vis-a-vis it's subsidiaries abroad. The question that must be answered is why one is interested in these changes that may take place. The basic justification for gathering such information is to determine the degree to which the subsidiary becomes self-sufficient both in its operations and in its productive and marketing efforts. The degree to which the subsidiary is independent and, as a result, in a position to undertake maximum potential development, may be important in determining the degree to which direct investment is a positive or negative factor in the economy of the capital-receiving country.

Decision-Making Within CDIA Firms

1. Examples of personnel and policy integration of parent and subsidiary operations can be cited as they relate to the age of the subsidiary, the complexity of its operations and problems it encounters. Integration may also result from the development of production integration. Such may be the case with Moore which is a vertically integrated firm in that the business forms subsidiaries rely on the machinery subsidiaries for their equipment. A similar example could be Polymer where the French subsidiary which produces specialty rubber may be highly dependent upon the butyl plant in Belgium. Accordingly, the firm may require highly centralized operations to ensure satisfactory operations.

2. Examples can also be given to illustrate the deficiencies of the definitions of direct investment with their supposed concomitant result of "control". Moore Corporation has three associated companies in which Moore has a 49 percent, 45 percent and 20 percent interest. Yet her influence over the operations of these companies may be far greater than her interest, or investment, would suggest. This influence would result not so much from the degree of ownership held by Moore but from experience in the field and control of specialized machinery produced by wholly owned subsidiaries and not sold to others. A similar case can be made for Cominco which has minority interests in two firms in India and Japan but may have majority influence because of her experience and developed state of her technology.

3. Little information is available from the firm profiles to permit valid comparisons between resident owned direct investment firms and non-resident owned direct investment firms located in Canada. Do they operate any differently? If so, in what way? Are the differences the function of differences in the residence of ownership? Unfortunately, no information seems to be available.

Corporate Citizenship of CDIA Enterprises Within Host Countries

To be a good corporate citizen, a direct investment firm should make decisions that relate to the "establishment of a community of interest" between the foreign countries and the Canadian firm resident therein. Unfortunately, however, for the purposes of this study, no information was available upon which to judge whether or not Canadian firms abroad are good or bad corporate citizens.

Possible Interdependency of Canadian Federal Government Policies Regarding CDIA and U.S. Federal Government Policies regarding the U.S. Balance of Payments

1. If there was active Canadian Federal Government intervention via, for example, special selective CDIA guarantees to encourage CDIA to flow to, and accumulate in, specific countries or groups of countries other than the U.S., Canada would be open to three related charges by the U.S. Federal Government.

   First, other things being equal, Canada by encouraging a relative shift of CDIA <u>away from</u> the U.S. would become less of a net contributor to the U.S. Balance of Payments in both the short-run and in the long-run (although dividend payments on CDIA from the U.S. would tend to be less than they otherwise would be in the long-run).

   Secondly, Canada by encouraging a relative shift of CDIA away from the U.S. would become a more attractive and apparent "leakage" point for U.S. savings and investments.

   Thirdly and relatedly, Canada by encouraging a relative shift of CDIA away from the U.S. would, at the aggregate savings level (<u>albeit</u> one step removed), be using U.S. savings to finance Canadian direct investment in countries other than the U.S. This argument could be put in a specific context: Canada, by creating special incentives for CDIA to flow to countries other than the U.S., would be using a back-door alternative technique of reducing potentially excessive Canadian foreign exchange reserves. And this would be breaking the spirit of the <u>quid pro quo</u> understanding reached about Canada's exemption from the I.E.T. and aspects of the U.S. Voluntary Program for financial institutions.

2. If the Canadian Government, as a matter of policy, decided to encourage the accumulation of CDIA in the economically underdeveloped countries of the world, the likelihood of U.S. Government retaliation could be expected to be somewhat less since the U.S. Government seeks to avoid any adverse effects of its Voluntary Program on these countreis (excluding Cuba, etc.). But the logic of this line of reasoning may have a serious flaw: the U.S. Government, by exempting certain underdeveloped countries from its Voluntary Program, receives the political credit; it would not receive the political credit for a Canadian initiative in increasing the accumulation of CDIA in the underdeveloped countries.

3. If Canada and Cuba reached an agreement to encourage the flow of CDIA to Cuba, the U.S. Government might be conceivably retaliative on economic and/or political grounds.

Canada's Foreign Aid Program and CDIA

1. Between 1954 and 1964, the relative share of CDIA in the more economically developed countries decreased from approximately 88 percent to 84 percent of the total. Almost the entire relative increase took place in "Other America".

2. At the present time the Canadian Federal Government does not appear to have an explicit policy of encouraging or discouraging CDIA to flow to, and accumulate in, underdeveloped countries. This "non-policy" may be in a state of transition.

3. There may be a conflict of assumptions in the minds of Government policy-formulators. On the one hand, there may be the assumption that CDIA assists the economic development of underdeveloped countries. On the other hand, there may be the assumption that private domestic savings are needed in Canada to encourage greater resident ownership and control of the Canadian economy (an "opportunity cost" of CDIA being greater non-resident control of certain sectors of the Canadian economy).

4. There seems little reason to believe that the U.S. Federal Government would look unfavourably at special programs by the Canadian Government to encourage the flow of CDIA to underdeveloped non-sino-soviet "dominated" countries.

5. The net economic and political costs to Canada of a greater accumulation of CDIA to underdeveloped countries remains an unanswered question.

Implications of the Royal Commission on Taxation for CDIA

Some of the recommendations of the Royal Commission on Taxation have a direct bearing on CDIA. However, the extent (if not the direction) of the influence of the Commission's recommendations on the outflow of, and accumulation of, CDIA is very much an open question. Several commentators believe that the Commission's recommendations would result in a slower rate of growth of CDIA than at present.

Implications of the Kennedy Tariff Round for CDIA

Other things being equal, lower tariffs will tend to make exports more competitive with new CDIA.

CHAPTER 3

RESEARCH METHODS AND LIMITATIONS

I

This study on Canadian Direct Investment Abroad (CDIA) was begun on June 15, 1967 with a time horizon of August 15th, 1967, for a preliminary report to the Task Force and August 31st, 1967 for a revised and more integrated report.

While at the outset it was thought that little research had been done specifically on CDIA, this assumption had, nevertheless, to be checked out and verified. A great deal of time in the first two weeks was devoted to finding out what research, if any, had been done on CDIA. This included investigation through many periodical indexes, book indexes, consultations with economists who were thought to have some knowledge of the area, correspondence with specialists at Canadian and American universities, etc. (See Appendices D and K). As a result of this survey, a preliminary bibliography on CDIA was prepared. Additions to this bibliography were made continuously throughout the research period as various leads unearthed new material. (See Appendix L).

The results of the initial survey of material on CDIA confirmed that very little research and analysis had been done in this area. Partly as a consequence, the original research outline was revised to be less ambitious in scope and the decision was taken that for the month of July, a great deal of time would be allocated to generating data and information on CDIA from DBS and particularly from a group of firms involved in CDIA.

II

Letters were written to 33 firms located in Canada which were thought to have direct investments abroad requesting them to send us their annual reports and other publications for the years 1954-55-56 and 1964-65-66. (See Appendix A). All but one firm replied to this request.* Letters were also written to 8 investment houses in Canada requesting them to send us any information or reports they had on the same 33 firms. (See Appendix B). Replies with information were received from 6 of these firms. Letters were also written to 21 foreign enterprises of three CDIA firms. Eight replies were received: Most of them referred the requests to their respective head offices. (See Appendix C.) Material collected in this way supplemented the material collected from available sources, such as The Financial Post Corporation Service. Firm Profiles were done on 18 of these firms.

Consultation with the Department of Trade and Commerce and DBS generated further data on companies engaged in direct investment abroad from Canada and on the aggregate statistics. Close consultation with DBS also helped to clarify statistical and definitional methods and concepts pertaining to CDIA.

III

Consultation with DBS underlined two severe restrictions on research into CDIA. Both these restrictions are reflected in this report. The most important limitation is that DBS was not able to provide a list of all the firms in Canada with direct investments abroad (in 1964 approximately 350 to 400 firms) because of the provisions of the Statistics Act: the Act prohibits DBS from making their list of such firms available to researchers outside of DBS. As noted below, the unavailability of this basic information imposed a severe methodological constraint on the research. The second limitation is that DBS data on CDIA is not as refined as their data on foreign direct investment in Canada (FDIC); for example, the classification by industrial detail of CDIA is much more general than the classification by industrial detail of FDIC. This lack of classification refinement of CDIA imposes severe limitations on the analysis of the aggregate statistics.

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* Canadian Food Products Ltd., Toronto, did not reply.

(DBS is completely aware of this limitation and hopes to be able to provide finer classifications in the years ahead. DBS was particularly helpful in supplying the research project with several specially compiled time series.)

The methodological limitation of not having the complete DBS list of firms engaged in CDIA, is straight forward. The 33 firms "selected" for the study (and the 18 "selected" for the profiles) were not selected in a random way (nor in a proper selective way) from the total population of CDIA firms since the total population was not known. This lack of proper statistical sampling throws open to question the validity of generalizations pertaining to the behavior of the total population of CDIA firms based on the firms included in this study. It could be argued, however, that the severity of this limitation would be reduced if it were known that the 18 firms for which profiles were completed accounted for 70 or 80 per cent of total CDIA. That is to say, it could be argued that what is important is not the way in which the companies were selected but the percentage coverage of total CDIA of the companies in the chosen group. However, even this percentage cannot be estimated with any degree of objective certainty: A main reason being that while DBS can make estimates of the direct investments abroad for each firm from the confidential data supplied by the firms, the public statements of most of the firms do not provide this information. For example, a firm located in Canada with direct investment abroad will inform DBS that the book value of its direct investments is $X million: but that firm might have a consolidated statement in its reports from which the value of its direct investments cannot be derived. While estimates could be made from the public reports of firms of the book value of their direct investments abroad, this would require much more time than is available for the completion of this report. A note of optimism should be added: While the selection of the 18 firms for more detailed study was not done in a proper statistical way, it seems likely (a subjective judgement) that most of the largest 13 firms (CDIA assets over $50 million in 1963) which account for 70 per cent of total CDIA assets are included in the 18 firms for which profiles were completed.

The 18 firms include a variety of firms in terms of the size of their CDIA, a variety in terms of products produced, a variety in terms of resident or non-resident controlled, a variety in terms of the geographical location of their foreign operations, a variety in terms of vertical and horizontal integration.

IV

It is important that each firm be identified by name for this makes an understanding of CDIA and the behavior of firms involved in it, more meaningful. An opportunity cost of doing this may be that sensitive internal information (particularly information relating to decision-making between the firm and its foreign enterprises) cannot be generated from the firms involved to the same extent as it could if the firms were told that they would be known only as "Firm X" and "Firm Y".

V

Firm Survey Data Sheets were then drawn up. (See Appendix F.) A great deal of time was spent in filling in these basic work sheets from which the 18 firm profiles could be prepared. There was tremendous variation of coverage among the firms in the data desired as well as a tremendous variation in terms of the comparability of data. The firm profiles reflect an attempt to make the data comparable and equally comprehensive for the sake of any generalizations and comparisons that are made. However, a great deal more time would have to be spent on cross-checking the basic data before more than tentative conclusions could be made.

VI

With regard to decision-making within CDIA firms, the initial reservations of generating relevant information in such a short research-period have been maintained. In particular, the assumption sometimes made that the degree of legal ownership of equity (both by a non-resident

individual and company) of the Canadian located firm (or of the foreign enterprise of the Canadian firm) is necessarily or significantly correlated to the degree of potential or exercised decision-making in a behavioralistic sense, is left open to question rather than accepted. Research into the methodologies that could be used to generate information on intra-firm decision-making has confirmed the initial assumption that a long-term period of research (as well as a proper research methodology with built-in cross-checks) would be required. As a consequence, systematic and structured interviews with company officials concerning their internal decision-making and political behavior were not attempted. This question is discussed in greater depth in Appendix G.

VII

The purpose of examining 18 firms in as much detail as possible was three-fold. First to find out very simple facts such as where their foreign operations were located, size of sales domestically and internationally, etc. Secondly, to see if their activities over the decade 1954 to 1964 would help to explain movements in the aggregate statistics from DBS, such as the relative geographical shift away from the U.S. from 76 per cent in 1954 to 60 per cent in 1964. Thirdly, to try to say something in the way of generalizations concerning their behavior as a group of 18 firms.

VIII

No attempt was made to formally correlate the aggregate statistics on CDIA and other possibly related statistics (growth rates in per capita income in foreign countries, etc.). Besides the time limitation for the preparation of this report, the number of observations (years) available on CDIA series could limit the usefulness of formal statistical correlations as would the small number of firms involved in CDIA (59 with CDIA assets of a book value $5 million or more).

IX

If the research period for this study of CDIA had been 12 months instead of 2 ½ months, a great deal more could have been concluded about the trends in the CDIA aggregate statistics (for example, which firms accounted for the trends) about decision-making in CDIA firms, about the advantages and disadvantages to Canada, etc. One severe limitation on the research would have been overcome: a full-time research assistant working solidly for 6 months could have uncovered the total population of CDIA firms from public sources (or the Statistics Act might have been amended to allow DBS to make their list available to an outside researcher). Given the total population of CDIA firms, a properly selected sample of firms could be of more use than the so-called sample used in this report; or a comprehensive study could be done of all the largest firms (say, all the largest 21 firms with CDIA assets $20 million or more); or a comprehensive study could be done of all the 350-400 CDIA firms which have been identified (and defined) by DBS. The most productive research approach would seem to be along the lines of case studies in depth as compared to the firm profiles in this report. Even this approach is limited, for the definition used by DBS to classify firms located in Canada as CDIA firms may be confining in terms of certain questions. Some of these constraints are discussed in the following Chapter.

X

In conclusion: the research approach used in this report is an ad hoc approach; it could better be described as a survey of existing publicly available data and information --- a gathering together in one place of what is available and sorting it out in some useful way. Partly because of the attempt to explore CDIA on a broad basis, the report definitely has a certain lack of focus. Hopefully the report is but a first step for more particular examinations of various aspects of CDIA. The report raises more hypotheses than it tests and many more questions than it answers. The attempt is made not to conclude more than the limited data (and often uncross-checked information) and research methods will allow. The attempt is made to clearly label speculation as speculation.

CHAPTER 4

Some Conceptual Problems and Limitations

I

The conceptual problems and limitations surrounding an analysis of FDIC also surround a similar analysis of CDIA. Some of these problems and limitations depend upon the questions which are asked. What is the most relevant definition of direct investment in terms of such questions? What are the limitations of the present definitions used to calculate official series? What is the significance of classifying direct investment as non-resident and resident owned and/or controlled? In addition to owning a proportion of a firm's equity, what techniques are possible for controlling or influencing decision-making within a firm with international operations, (monopoly, monopsony)? Where is the line between "control" of decision-making and "influence" over decision-making within the firm? One purpose of this report is to discuss such conceptual problems with respect to CDIA.

II

What is the distinction between CDIA and Canadian portfolio investment abroad in foreign securities? Both are classified by DBS as long run Canadian investment abroad. Presumably the definition that DBS uses for distinguishing between foreign direct investment in Canada and foreign portfolio investment in Canada, is the same definition for distinguishing between CDIA and Canadian portfolio investment abroad.

DBS defines foreign direct investment in Canada as follows:

> The category of direct investments ... generally includes all concerns in Canada which are known to have 50 per cent or more of their voting stock held in one country outside Canada. In addition a few instances of concerns are included where it is known that effective control is held by a parent firm with less than 50 per cent of the stock. In effect this category includes all known cases that are incorporated branches of foreign companies in Canada and all wholly-owned subsidiaries, together with a number of concerns with a parent company outside of Canada which holds less than all of the capital stock. In addition there are a relatively small number of companies included in cases where more than one-half of their capital stock is owned in a single country outside of Canada where there is not a parent concern. These exceptional cases are confined to instances where control is believed to rest with non-residents.(1)

There are other definitions of direct investment in use. The Canadian Income Tax Act (after 1951) defines the ownership test at a 25 per cent level. The U.S. Department of Commerce also used a bench-mark of 25 per cent. The Royal Commission on Taxation (Canada 1966) recommends that CDIA be defined as an investment by a Canadian resident or associated group of Canadian residents in a non-resident corporation (or in a foreign property or business) in which he or the group holds a 10 per cent or greater interest in the voting power, in the profits or in the assets distributed on liquidation of the non-resident corporation. (Only the DBS definition and the U.S. Department of Commerce definition are discussed below.)*

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* The quantitative significance of the different definitions of DBS and the U.S. Department of Commerce can be judged by the following example. DBS states that in 1959 there was $1,498 million (Canadian) of CDIA in the U.S. Making allowances for the U.S./Canadian exchange rate, the U.S. dollar value of the DBS estimate comes to approximately $1,562 million (U.S.). The U.S. Department of Commerce states that there was $1,896 million (U.S.) of CDIA in the U.S. in 1959. The DBS estimate comes to only 82 per cent of the U.S. estimate.

The purpose seems to rest on the assumption that a foreign enterprise which has a certain percentage of its voting stock owned by a domestic firm (50 per cent or 25 per cent) has relationships and trade transactions (exports/imports) with that firm which are different from the relationships and trade transactions between firms that do not have such a related ownership characteristic (even though in the latter case there may be a "portfolio" investment of 10 per cent).

Two related kinds of activity follow from the degree of ownership linkage. The first has to do with visible transactions of goods such as exports and imports: the distinction between direct investment and portfolio investment being helpful in terms of estimating supposedly diverse effects on the domestic nation's balance of international payments, for example.

The second kind of activity lies behind the first. It is much less visible, that is, the realm of inter-related decision-making. The deeper behavioralistic assumption seems to be that a 50 per cent or more (DBS) or a 25 per cent or more (U.S. Department of Commerce) ownership of the equity of a foreign enterprise brings with it "control" or "a controlling interest" of the foreign enterprise by the domestic firm. This assumption is stated by the U.S. Department of Commerce in these terms: "The major emphasis of foreign investment here (in the U.S.) has been on portfolio investments rather than the control and operation of industrial enterprises."(2) The U.S. Voluntary Program to Improve the U.S. Balance of Payments also assumes that U.S. direct investment abroad (the 25 per cent definition) brings with it control over decision-making of the foreign enterprises in which equity is owned: such U.S. firms being requested to repatriate income from abroad, to make the maximum possible use of funds from foreign capital markets for investment by their foreign affiliated enterprises, etc.(3) DBS seems to hedge* a great deal more than the Department of Commerce in jumping from a statistical definition of control based on equity ownership to control over decision-making (even though the DBS definition is basically a 50 per cent or more definition and the Department of Commerce's definition is a 25 per cent or more definition). DBS states:

> Even though the instances of potential control seem well established it must be recognized that there will be many variations in the extent to which this factor may in fact operate ... The position of the management of the concerns in Canada will vary greatly from one company to another. As this is a field where statistical measurements may not be applied it is not the purpose of this report to explore the question of the ways in which, and the extent to which control might be exercised. But certain clear cut influences which the existence of direct investment have on Canadian business should be pointed out.(4)

DBS then goes on to point out some of these "certain clear-cut influences" for example, industrial techniques and innovation ("there is less scope for innovation on the part of the subsidiary"), the geographic distribution of exports where the company is vertically integrated internationally, etc. And above all, according to DBS,

> direct investments affect the course of Canadian development. As such basic decisions as those concerned with the establishment or expansion of non-resident controlled firms rest with the interests controlling them, it is clear that the nature and direction of Canadian development are affected by the relationship.(5)

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* "The concept of control... needs to be carefully examined particularly before conclusions are drawn from the data." In another passage DBS says: "...Companies where a concern abroad has a substantial block of stock or where there is a known affiliation, the prospects of non-resident potential control also exists. But the influence of Canadian minority shareholders may often influence company policy and decisions. The remaining concerns included are the Canadian public companies where there is no parent concern, but where more than one-half the stock is held in either the U.S. or the United Kingdom. The ways in which non-resident control might operate in these cases are open to more questions than in the more typical example described above. (6)

It seems fair to say that while DBS has tried to meet the conceptual problem of applying a statistical definition (based on ownership of equity) as a measure of decision-making control, their discussion of the question is nevertheless ambivalent. While it is reasonable to say that a 50 per cent or more equity ownership brings with it "potential control" or a "potential controlling interest" over the decision-making of a foreign enterprise and that the degree of potential decision-making control is positively and significantly dependent on the degree of equity ownership from the wholly-owned subsidiary level to a 50-50 per cent joint venture level, other implications are open to serious question. For example, DBS does define investment as direct investment in instances where they believe that effective control is held by a parent firm with less than 50 per cent of the stock. This begs the question of possible circularity or the question of employing two definitions of control: on the one hand the definition of control is based on a statistical level of ownership of 50 per cent or more and on the other hand the definition is based on other criteria (behavioralistic and/or dependent on non-competitive market structures) as well as a degree of ownership (less than 50 per cent). As is pointed out in other sections of this report, it can be misleading to mix together a statistical definition of decision-making control based on equity ownership and a behavioralistic or market structure definition which may not be clear and explicit. (Could not a trade investment of 10 per cent plus a single buyer or seller market situation equal a wholly-owned subsidiary situation in terms of potential control over decision-making?) There is also a possible confusion between "potential" control and "exercised" control over decision-making at all levels of equity ownership. (DBS may have classified firms with 50 per cent or more equity ownership in a foreign enterprise as firms with "potential" decision-making control and at the same time included firms as CDIA firms with less than 50 per cent equity ownership in a foreign enterprise on the grounds of "exercised" control.) This distinction may be a particularly important one to make in any discussion of conflicts of national objectives. Several examples of the difficulties of an ownership definition of "potential" and "exercised" decision-making control might be noted in this chapter.

Moore Corporation has a wholly-owned subsidiary in Mexico (Moore Business Forms de Mexico), a 49 per cent equity interest in an enterprise in El Salvador (Moore Business Forms de Centro America), a 45 per cent equity interest in an enterprise in Japan (Toppan Moore Business Forms), and a 20 per cent equity interest in an enterprise in the United Kingdom (Lamson Industries Ltd.) DBS would classify the Mexican enterprise as CDIA and would likely classify the El Salvador and Japan enterprises as CDIA (49 and 45 per cent respectively). It is doubtful that DBS would classify the investment in the U.K. enterprise as CDIA. It does not follow that the degree of ownership of the various affiliated enterprises is a valid index of the degree of potential control over decision-making by Moore. As noted in greater detail in the Firm Profile on Moore Corporation, Moore has the largest research centre* in the area of business forms, stationery and specialty boxes (and for the machinery and equipment used to manufacture these products). Moore also produces the highly specialized machinery and equipment used to manufacture its products. Given Moore's policy of industrial secrecy and its "cornering" of research and the production of machinery and equipment, it can be hypothesized that these non-ownership levers give it potential effective control over the decision-making of its affiliated companies even though the level of ownership is 49 per cent, 45 per cent or even only 20 per cent. A similar hypothesis can be made for Cominco which has minority equity ownership in two firms (India and Japan) because of Cominco's experience and developed (and protected) technological know-how. Another example is Canadian Breweries Ltd. which has a 10 per cent equity interest in Charrington United Breweries (C.U.B.) in the U.K. (a holding company). Apparently Canadian Breweries

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* Moore Research and Service Company, Niagara Falls, New York.

III (Continued)

is the largest single shareholder, the rest of the voting stock being widely dispersed. It would be interesting to speculate on the potential role that Canadian Breweries could play in the current proposed merger of C.U.B. and another large brewery in the U.K. and what arrangements could be made concerning market sharing and market access among all the different participants. Another example is the Polymer Corporation which has a 40 per cent interest in the equity of a Mexican synthetic rubber plant. Polymer also provides management services to the new company. Accordingly Polymer's know-how (exercised by management provided by the parent) may provide far greater potential control than her 40 per cent equity would suggest. No doubt a similar case can be developed for Polymer's joint venture in South Africa in which Polymer has but a 20 per cent equity investment.

The above examples were given in the context of "potential" control over decision-making. There is the additional question of "exercised" as opposed to "potential" control over decision-making. These two aspects of control need not coincide. DBS, for example, uses the term "effective control" and seems at times to suggest that what is meant is "exercised" decision-making control. The distinction may be an important one to make when questions of "tied" transactions between CDIA firms and the foreign enterprises are discussed with reference to economic costs and benefits. Judgements on the degree to which potential control (not only via equity ownership) is exercised can probably best be made on the basis of depth case studies of individual firms. In such studies the following questions might be asked. What explains differences of exercised control over decision-making among CDIA firms in which the ownership of the voting stock of foreign enterprises is equal (for example at 80 per cent)? Variations in the degree of exercised control could also be noted at a low level of ownership of the voting stock (for example 20 per cent)?

It is hoped that the above discussion has pointed out some of the general anomalies of drawing a statistical line based on equity ownership and saying that those firms above the line are engaged in direct investment and those firms below the line are engaged in portfolio investment. While DBS includes some firms which are below their line in the direct investment category on the grounds that "effective control" is held by the firm, it is necessary to state explicitly whether or not "effective control" means "potential control" or "exercised control" and the criteria (behavioral or otherwise) used for arriving at such a judgement. More specific conceptual problems are noted below.

IV

Related to the above section, is a question of potential and exercised control over decision-making of a company by a non-resident group by means of non-ownership levers. Such cases are common in the literature on the theory of firm. For example, a highly specialized private foreign firm might because of its high degree of specialization, have only two or three purchasers of its specialized product.* These buyers, particularly if they act in collusion, could exercise potential control over the decision-making of such a company without owning any of its stock. One might find that where a particular foreign buyer of a product had such an influence that a "trade investment" might take place: That is, the supplier and the buyer would trade 10 per cent of their stock enabling each to have a member on the other's board of directors. The producer's representative on the buyer's board of directors might have very little

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* One of the purchasers may be a particular domestic or foreign government or government agency (for example in the production of defense or war goods). A great deal of the decision-making of such a firm could conceivably be effectively controlled by the relevant government without that government owing any of the voting stock of the company. This question is explored by J.K. Galbraith in his recent book The New Industrial State.

IV (Continued)

influence whereas the buyer's representative on the producer's board of directors might exercise effective decision-making control (or a veto power) on key issues rather than simply influencing such decisions. Such a case of a trade-investment of 5 or 10 per cent would be classified by DBS as a portfolio investment.

V

Another type of case where effective control over a firm's decision-making by a non-resident could take place without the non-resident owning any voting stock, lies within the area of licensing. Licenses are normally granted for a period of years and if the company wanted the license renewed it would have to take very careful consideration to any wishes the group granting the license wanted in terms of its operations.

VI

Another conceptual problem has to do with considering direct investment in isolation, that is, is it really meaningful to consider the economic impact of CDIA on a host country or on the "giving" country without considering the relationship between the direct investment and imports and/or exports?

For example, CDIA can be considered as a substitute for exports from Canada (or exports from a firm located in a third country controlled from Canada to the country in which a new direct investment operation has been established). Theoretically, at least while new CDIA represents the use of Canadian savings outside of Canada, the exports it replaces could conceivably be sold in Canada and, _if_ in Canada there was an inflationary situation, the additional goods placed on the market could help to stem that inflation. This in turn could be judged to have economic benefits to Canada (given a fixed exchange rate). This is the standard argument of bringing about internal and external balance by diverting increased production away from exports to the domestic market. Then there is the question in the longer run of new CDIA stimulating further exports to the country in which the new CDIA have been introduced. _If_ the assumption were made that there was excess production in Canada in the longer run (a recession) then the increased demand by foreigners for Canadian produced goods would tend to reduce the impact of the recession. It seems that the question of whether or not CDIA is good or bad for Canada rests very much on what is assumed about domestic inflation and recession and whether or not the reference point is the short run or the long run.

VII

Another conceptual question has to do with the meaning of dividing CDIA into a resident owned and "controlled" component and a non-resident owned and "controlled" component. It is most hazardous to equate resident owned and "controlled" with Canadian citizen owned and "controlled" and non-resident with foreign citizen owned and "controlled". For example, while 89 per cent of the equity in Interprovincial Pipelines (which has direct investment abroad) is held by residents and 11 per cent by non-residents (10 per cent in U.S. and 1 per cent elsewhere), Imperial Oil in Canada holds 33 per cent of the equity. Imperial Oil is owned by Standard Oil of New Jersey which brings the total direct and indirect non-resident ownership share in the U.S. to 43 per cent. If the resident owned share excluding Imperial Oil is widely dispersed, then there is a case for saying that the direct investment abroad of Interprovincial Pipelines should be considered as non-resident (potentially) "controlled" CDIA. It is not known how DBS in fact classifies this direct investment abroad of Interprovincial Pipelines. Another example is Alcan which is 29 per cent owned by residents, 68 per cent owned by residents of the U.S. and 3 per cent owned by other non-residents. It would be hazardous to

VII (Continued)

conclude from these statistics alone that Alcan is controlled by U.S. citizens for the 29 per cent owned by residents of Canada might be closely held by Canadian citizens and the non-resident portion widely dispersed. The Weston case is also interesting in that Garfield Weston is a non-resident Canadian citizen with extensive CDIA attributed to him.

It is hoped that the above examples have illustrated some of the obvious anomalies of any attempt to use a resident and non-resident ownership and "control" classification as an index of nationality of ownership and "control". If one of the purposes of using such a classification is to help to clasify variations in the degree of exercised control over decision-making between two firms located in Canada and their direct investment enterprises abroad then a great deal more behavioralistic information on the firms would be necessary. Furthermore, such variations might be found to be more closely associated with the nationality of the controlling groups rather than associated with the place of residence of the controlling groups when these two characteristics diverge (which may be common in the area of CDIA rather than the exception). It might also be noted that neither characteristic need be as important as other characteristics such as the nature of the products involved.

VIII

A much deeper question is whether or not costs and benefits of CDIA can be measured strictly in terms of capital flows. For example, there are also the technology flows and management flows that are associated with the capital flows in varying degrees. And in this wider context, concepts of various time-horizons are most relevant.

IX

There is another type of conceptual problem concerning the way in which DBS treats the investments abroad of Canadian insurance companies and chartered banks. In calculating the CDIA of these enterprises, DBS subtracts their liabilities abroad from their assets abroad. (The gross assets of the 125 branches, etc., abroad of Canadian chartered banks in 1954 amounted to $1,150 million. In 1954, DBS states that there were only $3 million worth of financial CDIA: in 1964, this had grown to $138 million. Presumably this is a growth in their gross assets abroad minus their liabilities abroad). The DBS statistics on CDIA in financial assets are much less, of course, than in other categories, particularly industrial and commercial. Yet it could be misleading to say from this that CDIA in industrial and commercial assets represents an area of decision-making control greater than in the financial area. For example, while net CDIA financial assets in the West Indies might be insignificant compared to industrial and commercial CDIA assets in the West Indies, it would be completely misleading to conclude that therefore the influence on the West Indian economy through controlled investment from Canada is greater in the industrial and commercial area than in the financial area. The DBS distinction is of course valid in terms of measuring Canada's international investment position: If, for example, the Canadian government wanted to use or repatriate (as a matter of public policy) CDIA abroad then the sellout of CDIA financial assets would not bring in a great deal of capital. But in terms of the impact on a foreign economy of CDIA the DBS statistics understate to a great extent the role of CDIA financial assets. Canadian insurance companies and chartered banks with controlled enterprises abroad could also have a large influence on Canadian exports --- perhaps just as large as the direct linkage between a Canadian controlled subsidiary abroad from the parent company in Canada.

Footnotes

(1) D.B.S., Canada's International Investment Position 1926-1954, Ottawa: Queen's Printer, 1956, P. 24.

(2) Office of Business Economics, U.S. Department of Commerce, Foreign Business Investments in the United States, Washington, D.C.: U.S. Government Printing Office, 1962, P. 3.

(3) Brimmer, A., "The U.S. Balance of Payments Program in Perspective", An Address to the Toronto Bond Traders Association, United States Information Service, Ottawa, March 3, 1966.

(4) D.B.S., Op. Cit.

(5) Ibid.

(6) Ibid.

CHAPTER 5

AGGREGATE STATISTICS*

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1. CHANGES IN CANADA'S BALANCE OF INTERNATIONAL INDEBTEDNESS.

2. THE CHANGING COMPOSITION OF CANADA'S LONG-TERM INVESTMENTS (ASSETS) ABROAD: THE RELATIVE IMPORTANCE OF CDIA (ASSETS).

3. CHANGES IN THE DOLLAR-VALUE OF CDIA ASSETS BY INDUSTRIAL DETAIL, WITH GROWTH RATES.

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16. CANADIAN DIRECT INVESTMENT ABROAD (CDIA) CLASSIFIED BY SIZE OF INVESTMENT.

17. NON-RESIDENT EQUITY AND CONTROL OF CDIA.

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* The primary data upon which summary tables in the Chapter are based are found in Appendix "J".

Changes in Canada's Balance of International Indebtedness, particularly 1954 - 1964

Canada's net international indebtedness increased from $7.0 billion in 1954 to $20.1 billion in 1964, an increase of 187 per cent. In terms of a longer run perspective, the dollar value of Canada's net international indebtedness for selected years was: $5.1 billion in 1926; $6.5 billion in 1930; $5.5 billion in 1939; $4.2 billion in 1945; $4.0 billion in 1949; and, $5.3 billion in 1951.

For the period 1954-1964, Canada's gross liabilities to the other countries increased from $13.9 billion to $32.8 billion, an increase of 136 per cent. For the same period, Canada's gross external assets increased from $6.9 billion to $12.7 billion, an increase of only 84 per cent. The effect of these two different growth rates was to reduce the ratio of assets to liabilities from about 50 per cent in 1954 to less than 39 per cent in 1964, a 22 per cent decrease in the ratio.

Canada's International Investment Position, 1954-1964

	Gross Liabilities to other countries[a]		Gross External Assets[a]		Assets/Liabilities		Canada's net international indebtedness	
	$B	1954=100	$B	1954=100	%	1954=100	$B	1954=100
1954	13.9	100.0	6.9	100.0	49.6	100.0	7.0	100.0
1964	32.8	236.0	12.7	184.1	38.7	78.0	20.1	287.1

(a) Includes equity of non-residents in Canadian Direct Investment Abroad (CDIA). In 1964, non-residents, through their ownership of equity in Canadian corporations accounted for $1,574 million or 47 per cent of the $3,356 million CDIA. In 1954 this ratio was 37 per cent.

The Changing Composition of Canada's Long-Term Investments (Assets) Abroad, particularly 1954-1964: The Relative Importance of CDIA (Assets)

In 1964, Canada's long-term investments* (assets) abroad had a dollar value of $6.8 billion, or 64 per cent of gross external assets. On the whole, long-term investments have been decreasing as a proportion of external assets since 1930 at which time such investments accounted for 84 per cent of external assets. (This last statement assumes that the World War II period is "abnormal", the ratio of 1945 was 51 per cent, for example). The 1954 ratio was 62 per cent. Another way of stating this changing relationship between long-term investments abroad and gross external assets is that while gross external assets (excluding long-term investments) increased by 127 per cent between 1954 and 1964, long-term investments increased by only 60 per cent. Since the concern of this Report is with long-term investment in the form of direct investment abroad, no attempt is made to describe or analyse the residual (short-term) assets.

CDIA was valued at $1,619 million in 1954 and $3,350 million in 1964, an increase of 107 per cent. Portfolio investment was valued at $926 million and $1,932 million for the two years respectively, an increase of 109 per cent. Government of Canada credits were valued at $1,705 million and $1,517 million respectively, a decrease of 11 per cent.** Consequently, the relative shares of these three components of Canadian long-term investments abroad for 1954 and 1964 shifted: CDIA increasing from 38 per cent to 49 per cent; portfolio investment increasing from 22 per cent to 28 per cent; and, Government of Canada credits decreasing from 40 per cent to 22 per cent.

If Government of Canada credits are excluded from Canadian long-term investments abroad, the following changing relative shift in importance of direct investment vis-a-vis portfolio investment can be noted. Whereas there

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* In the discussion, long-term investments include: direct investments in branches, subsidiaries and controlled companies; portfolio investments in foreign securities; and, Government of Canada credits (excluding subscriptions to international investment agencies and miscellaneous investments which, in 1964, were $0.1 billion and $0.4 billion respectively; "miscellaneous investments" consist primarily of export credits extended from Canada directly or indirectly at risk to the Government of Canada.)

** Between 1963 and 1964, Government of Canada credits increased by 18 per cent rather than continuing its normal annual decline of approximately 3 per cent. This was due to the inclusion in 1964 of $219 million medium-term non-marketable U.S. Government securities acquired under the Columbia River Treaty Arrangements. For the period 1954 to 1963, the decrease was 25 per cent compared to the 1954 to 1964 decrease of 11 per cent.

was no relative shift between 1954 and 1964 (direct investment being 64 per cent of total direct and portfolio investment), in 1926 and 1930 direct investment was 45 per cent and 36 per cent of the total respectively. That is, in the longer run perspective CDIA has been increasing in importance relative to Canadian portfolio investment in foreign securities.*

Whereas Government of Canada credits** since World War II have accounted for more than 20 per cent of total Canadian long-term investments abroad (22 per cent in 1964, 56 per cent in 1949), during the 12 year period prior to World War II they accounted for less than 5 per cent. Most of the Government of Canada credits were made in the post-World War II period. DBS describes this aspect of Canadian long-term investments abroad as follows:

> The only loans made by Canada during the war were an interest-free loan of $7 million made to the United Kingdom in 1942 before the Canadian Government provided the Contribution and Mutual Aid which were used for financing British and other allied war deficits in Canada, and a $10 million wheat loan extended to the U.S.S.R.... The former loan ... was fully repaid by the end of 1958 ...(and) the latter loan was fully repaid by the end of 1947.
>
> In the early post-war years Canada embarked on a large scale program of post-war credit extension to facilitate foreign purchases of goods and services and to assist in making it possible for overseas countries to meet transitional post-war deficits in their balance of payments, to maintain adequate reserves and to assume the obligations of multi-lateral trade...
>
> By the end of 1965 the outstanding balance on the loans of nearly $2,500 million extended by Canada since the beginning of the Second World War amounted to $1,360 million, including $83 million deferred interest on the 1946 loan to the U.K.[1]

As noted in the previous section, Canada's gross external assets increased by only 84 per cent between 1954 and 1964 whereas Canada's gross external liabilities increased by 136 per cent. At

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* It should be noted that there have been "important developments in connection with portfolio investments abroad since 1964. Net Canadian purchases of foreign securities from the end of 1964 through to the first quarter of 1967 totalled $535 million." (DBS). In 1964 such investment was $1,932 million. The rapid growth rate since 1964, may affect any projections based on the 1954-1964 data.

** excluding Government of Canada subscriptions to international investment agencies and miscellaneous investments. See previous footnote to this section.

the beginning of this section it was noted that long-term investments abroad increased by only 60 per cent and that gross external assets other than long-term investments increased by 127 per cent, the latter increase being almost as great as the increase in Canada's external liabilities. As noted above, the components of Canada's long-term external investments showed different rates of change: direct and portfolio investments increasing by 107 per cent and 109 per cent respectively, while Government of Canada credits decreased by 11 per cent. In terms of a longer run perspective, the growth of CDIA from 1926-30 to 1964 has been greater than the growth of Canada's gross external liabilities (approximately 745 per cent and 356 per cent respectively). In contrast to the growth of CDIA since the last half of the 1920's, portfolio investment increased by only 200 per cent. *

Another way of viewing the changing growth rates of Canada's gross external liabilities and the components of Canada's gross external assets is the following. For the period 1954 to 1964 the ratio of gross external assets to gross external liabilities decreased from 49 per cent to 39 per cent. The ratio of long-term external assets to gross external liabilities decreased from 31 per cent to 21 per cent. The ratio of CDIA to gross external liabilities decreased from 12 per cent to 10 per cent. Another interesting ratio is that of resident owned equity of CDIA to gross external liabilities: this decreased from 7 per cent to 5 per cent. Using indices for the above statistics with 1954=100, the following results are obtained. The ratio of gross external assets to gross external liabilities decreased by 22 per cent. The ratio of long-term external assets to gross external liabilities decreased by 32 per cent. The ratio of CDIA to gross external liabilities decreased by 13 per cent. The ratio of resident owned equity of CDIA to gross external liabilities decreased by 27 per cent. The conclusions by using indices of these ratios are the same as noted

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* If the comparative growth ratio were calculated for the period 1926-30 to 1967, the gap between the CDIA growth rate and the portfolio investment growth rate would probably narrow considerably.

previously. Long-term external assets grew at a slower rate than short-term external assets. CDIA grew at a faster rate than total long-term external assets and gross external assets. In addition, resident owned equity of CDIA increased at a slower rate than gross external assets and total CDIA, but at a faster rate than total long-term external assets. *

In terms of a longer run perspective (1926-1930) the significant results are that gross external assets have grown at a faster rate than gross external liabilities and that long-term external assets and CDIA by itself have also grown at a faster rate than gross external liabilities.

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* The possible significance of the gap between the negative growth rate of the ratio of CDIA/gross external liabilities (-13 per cent) and the larger negative growth rate of resident owned equity of CDIA/gross external liabilities (-27 per cent), is discussed in a separate section.

Gross External Assets and Selected Components
as a percentage of Gross External Liabilities, Selected Years

	1926-30	1954	1964
Gross External Assets/Gross External Liabilities	19.4	49.4	38.7
(Index 1954=100)	(39.3)	(100.0)	(78.3)
Long-term External Assets/Gross External Liabilities	15.2	30.5	20.8
(Index 1954=100)	(49.8)	(100.0)	(68.2)
CDIA/ Gross External Liabilities	5.8	11.7	10.2
(Index 1954=100)	(49.6)	(100.0)	(87.2)
Resident owned equity of CDIA/Gross External Liabilities	N.A.	7.4	5.4
(Index 1954=100)	(N.A.)	(100.0)	(73.0)

Long-term Investments (Assets) Abroad, 1954 and 1964

	CDIA			Portfolio			Government of Canada Credits		
	$M	1954=100	Share %	$M	1954=100	Share %	$M	1954=100	Share %
1954	1,619	100.0	38.1	926	100.0	21.8	1,705	100.0	40.1
1964	3,356	207.3	49.3	1,932	208.6	28.4	1,517	89.0	22.3

Changes in the dollar-value of CDIA Assets
by Industrial Detail, with growth rates, particularly 1954 - 1964

The dollar value of total CDIA assets increased from $1,619 million to $3,356 million in 1964, a growth of 107 per cent. In terms of a longer run perspective, CDIA assets stood at $397 million in 1926, $671 million in 1949 and $926 million in 1949.

Between 1954 and 1964, the fastest growing components of CDIA were the financial* and all other (miscellaneous) categories: these components, however, had such a small value in 1954 that their growth rates are not in themselves very meaningful. The industrial/commercial (excl. beverages) and petroleum components had growth rates significantly above the total growth rate of CDIA. There was a negative growth rate in the railway component. The beverages and utilities other than railways components had growth rates significantly below the total growth rate of CDIA. The mining component had a growth rate almost identical to the total growth rate of CDIA.

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* Since 1964 there has been a considerable reversal in the financial category (Delta).

Dollar Value of CDIA (Assets), Industrial Detail, 1954 and 1964

	1954 $m	1964 $m	---1954-1964---- Percentage increase	Rank
Industrial/Commercial (excl. Beverages)	495	1,367	176	(3)
Beverages	440	720	64	(6)
Petroleum *	112	284	154	(4)
Mining	133	278	109	(5)
Railways	273	270	-1	(8)
Other Utilities **	154	216	40	(7)
Financial	3	138	4,500	(1)
Other (miscellaneous)	9	80	789	(2)
TOTAL	1,619	3,356	107	

* Excludes pipelines (which account for most of "Other Utilities" in the United States).

** Includes pipelines.

Changes in the Relative Industrial Detail of CDIA, particularly 1954 - 1964

Between 1954 and 1964 there was a relative shift in the industrial detail of CDIA.* This shift has been primarily away from railways, other utilities (including pipelines), and beverages to industrial/commercial (excluding beverages), petroleum, and financial. The percentage share of mining has remained unchanged.

In a longer run perspective, some of the same trends are evident, railways and other utilities combined declining from 37 per cent in 1939 to under 15 per cent in 1964 and industrial and commercial (including beverages) increasing from 43 per cent to 63 per cent in the same period. (DBS has not yet separated beverages from the broad category of industrial and commercial prior to 1954.)**

The shift towards industrial/commercial (excluding beverages) from 31 per cent in 1954 to 41 per cent in 1964 was brought about by one half of the increase in CDIA for the decade being allocated to industrial/commercial concerns (excluding beverages).

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* A "relative" downward shift does not, of course, mean that the "absolute" book value of CDIA assets in any particular category has fallen.

** DBS was most helpful in supplying this report with special continuous series for the period 1954-1964.

CDIA (Assets), Industrial Detail, 1954 and 1964

(Percentage)

	1954	(Rank)	1964	(Rank)
Industrial/Commercial (excl. Beverages)	30.6	(1)	41.3	(1)
Beverages	27.2	(2)	21.5	(2)
Petroleum *	6.9	(6)	8.5	(3)
Mining	8.2	(5)	8.3	(4)
Railways	16.9	(3)	8.1	(5)
Other Utilities **	9.5	(4)	6.4	(6)
Financial	.2	(8)	4.1	(7)
Other	.6	(7)	2.4	(8)
TOTAL	100.3		100.[illegible]	

* Excludes pipelines (which account for most of "Other Utilities" in the United States).

** Includes pipelines.

Increase in CDIA (Assets), Industrial Detail, 1954 and 1964

	Increase in all countries		% of total CDIA (Assets)	
	$m	% of total increase	1954	1964
Industrial/Commercial (excl. Beverages)	872	50	31	41
Beverages	280	16	27	22
Petroleum	172	10	7	[illegible]
Mining (incl. pipelines)	145	8	8	6
Railways	-	0	17	8
Other Utilities	62	4	10	[illegible]
Financial	135	8	-	4
Other	71	4	1	2
TOTAL	1,737	100	101	100

Changes in the dollar-value of CDIA Assets
by Geographical Distribution, with growth rates, 1949, 1954, and 1964

Between 1954 and 1964, the geographical areas with the fastest CDIA growth rates were the Common Market and other Europe (excl. U.K.), and Other America (other than the U.S. and Latin America). While these areas had rather low absolute values of CDIA assets in 1954, their growth rates are nevertheless meaningful. The U.K. growth rate was well above the total growth rate of CDIA and is based on significant CDIA in 1954. The high Asia growth rate is not very meaningful due to the low base in 1954. The high Australasia growth rate is as significant as the Common Market and Other America growth rates. The very low U.S. growth rate is most meaningful. The very low Africa and the average Latin American growth rates are meaningful. (The Commonwealth excl. U.K. grouping, which cuts across the other groupings, had a significant growth rate starting from a dollar-value level slightly greater than that of the U.K. in 1954.)

In terms of a longer run perspective, the 1954-1964 geographical decade "trends" are, on the whole, part of the trend pattern since 1949. The main differences are a more rapid relative decline of the U.S. CDIA growth rate for the 1954-1964 period than for the 1949-1954 period and a more rapid relative increase in the Common Market and other Europe growth rate in the later period than in the earlier period.

Changes in the Relative Geographical Distribution of CDIA (Assets), particularly 1954 - 1964

Between 1954 and 1964 there was a relative shift in the geographical distribution of CDIA.* This shift has been primarily away from the U.S. to the rest of the world (R.O.W.). The share of Latin America has remained almost constant. The share of Africa as a whole (and the non-Commonwealth African countries in particular) has declined.

Between 1954 and 1964 the expansion of CDIA (assets) in the U.S. accounted for approximately 46 per cent of the total increase in CDIA (assets) which brought the U.S. share of total CDIA (assets) down from 76 per cent in 1954 to 60 per cent in 1964.

In a longer run perspective, the U.S. share has returned to its 1926-30 level. The U.K. share, in contrast, has increased over five-fold from its 1926-30 level. Even so, in 1964 the U.S. accounted for over 60 per cent while the total amount of direct investment from Canada in the U.K. continued to be a comparatively small part of total investments (under 14 per cent).

A ranking primarily by continent in terms of 1964 shares, results in the following order: U.S.; U.K.; Other America (other than the U.S. and Latin America, i.e. includes sterling area countries and French and Dutch possessions); Common Market and other Europe; Latin America; Australasia (Australia, New Zealand, and the rest of Oceania): Africa (including South Africa); and Asia. Since 1954, Europe and Other America have become more important than Latin America and Africa.

As would be expected, annual Canadian Direct Investment Flows abroad (as shown in the balance of payments statistics) give similar evidence of this shift since 1954, the flow of funds to the U.S. being relatively less in the first half of the 1960's than in the middle of the 1950's. It is significant that the category of

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* A "relative" downward shift does not, of course, mean that the "absolute" book value of CDIA assets in any particular country or grouping of countries has fallen.

"Other OECD in Europe"* has increased its share of the flow for if this continues, CDIA (assets) in these OECD countries could, over the period 1964-74, increase at a faster rate than for other countries or groups of countries.
(The selection of the unequal time-periods, 1954-57 and 1960-65, is subjective: the selection criterion was to eliminate or to smooth over, very abnormal years for particular countries, for example in 1958 there was no net Canadian direct investment flow to the U.S.).

The results of this geographical shift of CDIA assets or "stock" and CDIA flows seem also to be reflected in the geographical distribution of the flow of dividend receipts to Canada on CDIA. While the dividend receipt shift likely reflects different geographical profit cycles (among many other influences)** as well as a relative geographical shift in CDIA (perhaps itself partly a function of such profit cycles), the net result is at least consistent with the shifts in the previous indices. The shift away from the U.S. measured by the dividend index does not, however, seem to be as large as the shift indicated by the previous indices. This seems reasonable since a dividend geographical shift could well lag behind the geographical shift in the outflow of CDIA. The dividend shift could become more apparent for the period 1965-70.

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* Austria, Belgium, Luxembourg, Denmark, Greenland, France, Federal Republic of Germany, Greece, Italy, Netherlands, Norway, Portugal, Spain, Switzerland and Turkey.

** There are many factors which could influence the size of dividend receipts in any period and between two periods: views about the exchange rate, liquidity, interest rate differentials, exchange controls (potential as well as actual) political stability including the possibility of nationalization, the interaction of tax legislation in Canada and in foreign countries, corporate financing policy, etc.

Dollar Value of CDIA Assets, by Geographical Distribution, 1949,1954 and 1964*

	1949	1954	1964	--- 1954-1964 ---	
	$m	$m	$m	Percentage increase	Rank
U.S.	721	1,231	2,025	65	(7)
U.K.	59	119	457	284	(3)
Latin America	47	77	167	117	(6)
Other America	25	55	255	364	(2)
Africa	20	48	65	35	(8)
Common Market and other Europe	19	34	191	462	(1)
Australasia	25	40	141	253	(5)
Asia	10	15	55	267	(4)
(Commonwealth countries excl. U.K.)	(76)	(138)	(426)	(209)	
TOTAL	926	1,619	3,356	107	

*This particular geographical distribution is not available from DBS prior to 1949.

CDIA (Assets), Relative Geographical Distribution
1954 and 1964

	1954	(Rank)	1964	(Rank)
U.S.	76.0	(1)	60.3	(1)
U.K.	7.4	(2)	13.6	(2)
Latin America	4.8	(3)	5.0	(5)
Other America	3.4	(4)	7.6	(3)
Africa	3.0	(5)	1.9	(7)
Common Market)	2.1	(7)	3.3) 5.7	(4)
Other Europe)			2.4)	
Australasia	2.5	(6)	4.2	(6)
Asia	.9	(8)	1.6	(8)
(Commonwealth excl. U.K.)	(8.5)	(-)	(12.7)	(-)
TOTAL	100.1		99.9	

CDIA (Flow), Relative Geographical Distribution
1954-57 and 1960-65

	1954-57	1960-65
U.S.	60.8	30.2
U.K.	5.8	15.8
Other Sterling	18.9	25.4
Other OECD in Europe	1.4	19.3
All Other	13.1	9.3
TOTAL	100.0	100.0

Dividend Receipts on CDIA, Relative Geographical Distribution
1954-57 and 1960-65

	1954-57	1960-65
U.S.	49.7	40.0
U.K.	14.8	22.1
All other countries	35.5	38.0
TOTAL	100.0	100.1

Changes in the Relative Geographical Distribution of CDIA (Assets), by Industrial Detail, particularly 1954 and 1964

In every industrial classification used by DBS there was a relative shift away from the U.S. to the R.O.W. except in railways. CDIA in railways remained completely in the U.S.

In 1954 the U.S. share of industrial/commercial (including beverages) CDIA assets was 73 per cent. Between 1954 and 1964, the U.S. received only 41 per cent of the increase thereby reducing its share of such CDIA assets at the end of the period to 56 per cent.

In 1954 the U.S. share of petroleum CDIA assets (excluding pipelines) was 95 per cent. Between 1954 and 1964, the U.S. received 90 per cent of the increase thereby reducing its share of such CDIA assets at the end of the period to 92 per cent.

In 1954 the U.S. share of mining CDIA assets was 29 per cent. Between 1954 and 1964, the U.S. experienced a slight absolute dollar-value decline of such CDIA assets thereby reducing its share at the end of the period to 13 per cent.

In 1954, the U.S. share of CDIA assets in utilities other than railways (including pipelines) was 76 per cent. Between 1954 and 1964, the U.S. received only 55 per cent of the increase thereby reducing its share of such CDIA assets to 70 per cent.

In 1954 all CDIA financial assets ($3 million) were located in the U.S. Between 1954 and 1964, the U.S. received 83 per cent of the increase ($135 million) thereby reducing its share of such CDIA assets at the end of the period to 83 per cent.

In 1954 the U.S. share of All Other CDIA assets was 76 per cent. Between 1954 and 1964, the U.S. received only 34 per cent of the increase thereby reducing its share of such CDIA assets at the end of the period to 39 per cent.

Increase in CDIA (Assets) 1954 to 1964,
Industrial Detail, and U.S. Shares

	1954-1964 Increase in all countries $m	1954-1964 Increase in U.S. only $m	U.S. share of total increase %	U.S. share of total assets 1954 %	U.S. share of total assets 1964 %
Industrial/Commercial (incl. Beverages)*	1,152	472	41	73	56
Petroleum	172	155	90	95	92
Mining (incl. pipelines)	145	-3	-2	29	13
Railways	-	-	-	100	100
Other Utilities	62	34	55	76	70
Financial	135	112	83	100	83
Other	71	24	34	78	39
TOTAL	1,737	794	46	76	60

* The geographical distribution of Beverages is not available from DBS. In 1954, $420 million of CDIA assets in the U.S. was in brewing, distilling, and beverage industries.(2) DBS stresses that this calculation is not comparable to the special time series they prepared for this report on the growth of CDIA beverage assets. _If_ the two calculations were comparable for 1954, then the U.S. share would be 96 per cent.

Changes in the Relative Geographical Distribution of the Industrial/Commercial (including Beverages) Components of CDIA, particularly 1954-1964

On a world-wide basis, as noted above, industrial/commercial (including beverages) CDIA assets were relatively more important in 1964 than in 1954 (or in 1939), their combined book-value increasing by 123 per cent compared to a 107 per cent increase of total CDIA. (Within this classification, beverages increased by only 64 per cent, much less than the 107 per cent increase in total CDIA.)* Industrial/commercial assets accounted for almost 58 per cent of total CDIA assets in 1954 and almost 63 per cent in 1964.

Between 1954 and 1964, the U.S. experienced a decrease in its relative share of CDIA in industrial/commercial assets and the U.K. and all other non-Commonwealth countries as a group experienced a significant increase. Commonwealth countries (other than the U.K.) experienced no significant relative change. In terms of a longer run perspective, the U.S. share has dropped below its 1939 level (61 per cent), the shares of the U.K. and other Commonwealth countries have increased almost to their 1939 levels and all other countries as a group have increased slightly beyond their 1939 level.

While the U.S. accounted for about 56 per cent of CDIA in industrial/commercial concerns in 1964, the relative decline since 1954 contributed significantly to the total decline of the U.S. share of all CDIA assets. Furthermore, since industrial/commercial assets accounted for almost 58 per cent of total CDIA assets in 1954 and almost 63 per cent in 1964 the significance is much more important than the relative shift in, for example, mining which has a much smaller percentage weight.

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* Unfortunately, the geographical distribution of beverages is not available from DBS. Beverages (which includes products from breweries and distilleries and non-alcoholic beverages) accounted for 27 per cent of total CDIA in 1954 and less than 22 per cent in 1964 while industrial/commercial (excluding beverages) accounted for about 31 per cent and 41 per cent in 1954 and 1964 respectively.

CDIA (Assets) in Industrial/Commercial Concerns
Geographical Distribution, 1954 and 1964

	1954	1964
U.S.	73.4	55.5
U.K.	12.6	20.7
Other Commonwealth	7.9	8.9
All other countries	6.1	14.9
TOTAL	100.0	100.0

Changes in the Relative Geographical Distribution of the Petroleum Component of CDIA, 1954-1964

On a world-wide basis, as noted above, petroleum CDIA assets (excluding pipelines) were relatively more important in 1964 than in 1954, their book value increasing by 154 per cent compared to a 107 per cent increase of total CDIA. Petroleum assets accounted for about 7 per cent of total CDIA assets in 1954 and slightly less than 9 per cent in 1964.

Between 1954 and 1964, the U.S. experienced a small decrease in its relative share of CDIA in petroleum assets and Commonwealth countries including the U.K. as a group increased their share from nothing in 1954. All other countries as a group experienced a small decrease.

Since the relative shift away from the U.S. was small and since petroleum assets accounted for less than 9 per cent during the 1954-1964 period, the petroleum shift was not very significant in the total decline of the U.S. share of all CDIA assets.

CDIA (Assets) in Petroleum Concerns,
Geographical Distribution, 1954 and 1964

	1954	1964
U.S.	94.6	91.9
U.K.	-	.4
Other Commonwealth	-	3.2
All other countries	5.4	4.6
TOTAL	100.0	100.1

Changes in the Relative Geographical Distribution of the Mining Component of CDIA, 1954-1964

On a world-wide basis, as noted above, mining CDIA assets were of almost the same relative importance in 1964 as they were in 1954, their book value increasing by 109 per cent compared to a 107 per cent increase of total CDIA. Mining assets accounted for little more than 8 per cent of total CDIA assets in 1954 and 1964.

Between 1954 and 1964, the U.S. experienced an absolute decrease in the value of mining CDIA assets which, in conjunction with the total R.O.W. growth, lead to a significant decrease in its relative share. There has been, and is, no CDIA in mining in the U.K. Commonwealth countries other than the U.K. as a group experienced a significant increase in their relative share. All other countries experienced a moderate increase.

The significant relative decline in the U.S. share of CDIA in mining contributed to the total decline of the U.S. share of all CDIA assets. However, since mining accounted for only slightly more than 8 per cent of total CDIA assets in 1954 and 1964, the significance is not as important as the shift in, for example, industrial/commercial which has a much larger percentage weight.

CDIA (Assets) in Mining Concerns,
Geographical Distribution, 1954 and 1964

	1954	1964
U.S.	29.3	13.0
U.K.	-	-
Other Commonwealth	45.1	57.6
All other countries	25.6	29.6
TOTAL	100.0	100.2

Changes in the Relative Geographical Distribution of the Railway and Other Utilities Components of CDIA, particularly 1954-1964

On a world-wide basis, as noted above, CDIA assets in railways and other utilities (including pipelines) were relatively less important in 1964 than in 1954 (or in 1939), their combined book value increasing by less than 15 per cent compared to a 107 per cent increase of total CDIA. Railways and other utilities (assets) accounted for about 26 per cent of total CDIA assets in 1954 and about 15 per cent in 1964. There was no growth at all in railways, the total growth in railways and other utilities as a group being accounted for by a 40 per cent increase in non-railway utilities.

CDIA in railways has been, and is, located exclusively in the U.S. Other utilities are located in the U.S. and in many other countries. Pipelines account for most of the other utilities in the U.S.

Between 1954 and 1964 the U.K. and other Commonwealth countries experienced an increase in their relative share of utilities other than railways and the U.S. and all other countries as a group experienced a decrease. This was a continuation of a longer run trend since 1939.

While the U.S. continued to account for 70 per cent of CDIA in other utilities in 1964, the relative decline since 1954 contributed to the total decline of the U.S. share of all CDIA assets. However, since railways and other utilities accounted for only about 26 per cent of total CDIA assets in 1954 and about 15 per cent in 1964, the significance is not as important as the shift in, for example, industrial/commercial which has a larger percentage weight. It is, of course, more significant than the shift in other individual industrial groups.

CDIA (Assets) in Utilities other than Railways, Geographical Distribution, 1954 and 1964

	1954	1964
U.S.	76.0	69.9
U.K.	.7	3.7
Other Commonwealth	2.6	9.7
All other countries	20.8	16.7
TOTAL	100.1	100.0

Changes in the Relative Geographical Distribution of the Financial Component of CDIA, 1954-1964

On a world-wide basis, as noted above, financial CDIA assets were relatively more important in 1964 * than in 1954: in 1954 financial CDIA assets had a book value of $3 million and in 1964, $138 million. Financial CDIA assets** accounted for less than 1 per cent of total CDIA assets in 1954 and slightly more than 4 per cent in 1964.

In 1954 CDIA in financial assets were located exclusively in the U.S. Between 1954 and 1964 some CDIA in financial assets flowed to the U.K. and other Commonwealth countries. A token amount also went to all other countries as a group.

While the U.S. continued to account for 83 per cent of CDIA in financial assets in 1964, the relative decline since 1954 contributed to the total decline of the U.S. share of all CDIA assets. However, since financial CDIA assets accounted for less than 1 per cent of total CDIA assets in 1954 and 4 per cent in 1964, the significance is not as important as the shift in, for example, industrial/commercial which has a larger percentage weight.

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* There has been a considerable reversal in the financial category since 1964.

** These are net of liabilities to non-residents.

CDIA (Assets) in Financial Concerns,
Geographical Distribution, 1954 and 1964

	1954	1964
U.S.	100	83
U.K.	-	7
Other Commonwealth	-	8
All other countries	-	2
TOTAL	100	100

Changes in the Relative Geographical Distribution of the All Other Component of CDIA, 1954-1964

On a world-wide basis, as noted above, all other (miscellaneous) CDIA assets were relatively more important in 1964 than in 1954: in 1954 miscellaneous CDIA assets had a book value of $9 million and in 1964, $80 million. These miscellaneous assets accounted for less than 1 per cent of total CDIA assets in 1954 and between 2 and 3 per cent in 1964.

In 1954 CDIA in miscellaneous assets were located in the U.S. and countries other than the U.K. and the rest of the Commonwealth. Between 1954 and 1964 some CDIA in miscellaneous assets flowed to the U.K. and other Commonwealth countries.

The relative decline in the U.S. share of miscellaneous CDIA assets since 1954, contributed to the total decline of the U.S. share of all CDIA assets. However, since miscellaneous assets accounted for less than 1 per cent in 1954 and between 2 and 3 per cent in 1964, the significance is only marginal.

CDIA (Assets) in all Other Concerns,
Geographical Distribution, 1954 and 1964

	1954	1964
U.S.	78	39
U.K.	-	8
Other Commonwealth	-	49
All other countries	22	5
TOTAL	100	101

Changes in the Ratio of CDIA to Foreign Direct Investment in Canada (FDIC), Particularly 1954 - 1964

CDIA (Assets) increased from $1.6 billion in 1954 to $3.4 billion in 1964, an increase of 107 per cent. Foreign direct investment in Canada (FDIC) (Assets) increased from $6.8 billion dollars in 1954 to $15.9 billion in 1964, an increase of 134 per cent. Consequently the ratio of CDIA to FDIC declined from 23.5 per cent in 1954 to 21.4 per cent in 1964, a decrease of 9 per cent (or 2 percentage points).* In terms of the change in CDIA (Assets) and FDIC (Assets), the ratio of the CDIA increment to the FDIC increment was 18.7 per cent in 1954 and 50.8 per cent in 1964. This two-year comparison is not very meaningful since both time-series are quite volatile. There does appear, to be, nevertheless, a slight upwards shift in the ratio when the first part of the 1954-1964 period is compared to the latter part; if both 1954 and 1964 are excluded, the ratio for the first five years lies between 10.2 and 14.4 per cent and for the last four years between 17.0 and 39.3 per cent. This is a result of both a small upward "shift" in the CDIA increment and a small downward "shift" in the FDIC increment. It may be that that portion of the CDIA increment consisting of the outflow of funds from Canada was less important than CDIA from retained earnings and other factors (including the rising value of foreign currencies in terms of Canadian funds) in contributing the small upwards "shift" in the CDIA increment. (The ratio of CDI flows abroad to CDIA increment, "shifted" downwards from an average of about 60 per cent for 1955-59 and 45 per cent for 1960-63). If the slight short-run "shift" in the incremental ratio is an indication of a permanent shift, then the asset ratio of CDIA/FDIC will continue to increase from its post World War II low of 19 per cent in 1961.

In terms of a longer-run perspective, the ratio of CDIA (Assets) to FDIC (Assets) was: 22.2 per cent in 1926; 16.7 per cent in 1930; 30.4 per cent in 1939; 25.9 per cent in 1945; and 26.7 per cent in 1951. Since 1951, the ratio has declined.

CDIA and FDIC, Dollar Values and Ratios

	FDIC				CDIA				CDIA/FDIC	
	Assets		Increment		Assets		Increment		Assets	Increment
	$ B	1954=100	$ B	1954=100	$ B	1954=100	$ B	1954=100	%	%
1954	6.8	100	.76	100	1.6	100	.14	100	23.5	18.7
1956	8.9	131	1.1	150	1.9	119	.15	105	21.4	13.1
1960	12.9	190	.97	127	2.5	156	.19	131	19.4	19.3
1963	15.4	227	.77	102	3.1	194	.30	214	20.1	39.3
1964	15.9	234	.46	60	3.4	207	.23	163	21.4	50.8

* For the years 1958-1962 the asset ratio was in the 19.0 - 19.4 per cent range.

Dividend Receipts on CDIA (and Geographical Distribution),

and Divident Payments on FDIC, particularly 1954-1964.

Dividend receipts on CDIA increased from $63 million in 1954 to $188 million in 1964, an increase of 198 per cent. While the provisional 1965 value is $146 million, neither this figure nor the 1964 figure are representative of the dollar values for the total 1954-1964(65) period. (Whether or not they mark the beginning of an upwards shift is an open question.) The highest prior value was $92 million dollars in 1961 (a 46 per cent increase over the 1954 dollar-value of $63 million which was the lowest value for the period).

The outflow of CDIA increased from $90 million dollars in 1954 to $95 million in 1964, an increase of 6 per cent. The 1963 value was $135 million, an increase from 1954 of 50 per cent. This flow fluctuated between $40 million (1958) and $135 million (1964).

The ratio of CDIA receipts to CDIA outflows fluctuated between a low of 56 per cent (1963) and a high of 198 per cent (1964) for the 1954-1964 period. In seven of the eleven years the ratio was below 100 per cent and in four of the eleven years the ratio was above 100 per cent. For the eleven year period as a whole, the ratio of total receipts ($946 million) to total outflow ($950 million) was 100 per cent. In terms of Canada's balance of international payments, therefore, the inflow of dividend receipts directly neutralized the outflow of CDIA for the period. (As a definitional corollary, the reverse flows by themselves had no net direct effect on Canada's balance of international indebtedness). For the same period, total dividend payments on FDIC ($3,956 million) were only 73.7per cent of the inflow of FDIC ($5,370): the net direct effect of the two reverse flows, therefore, was to strengthen Canada's balance of payments (and to contribute to the increase in Canada's indebtedness on international account).

The ratio of dividend receipts on CDIA to dividend payments on FDIC has fluctuated between 17.9 per cent (1963) and 33.5 per cent (1964) over the 1954-1964 period. For five of the eleven years the ratio was above 22.5 per cent and for six of the eleven years below 22.5 per cent. It would appear that for the period as a whole, there has been no trend divergence in the growth rates of the two flow series.

The geographical source of CDIA receipts appears to have shifted slightly away from the U.S. to the R.O.W. during the 1954-1964 period. For example, the accumulative receipts for the period 1954-57 from the U.S. were 49.7 per cent of the total whereas for the period 1960-65 the U.S. accounted for only 40.0 per cent. (Note:- If 1958 is included in the early period and 1959 in the later period the gap narrows to 3.6 percentage points compared to 9.7 percentage.) In terms of a longer run perspective, the U.S. accounted for 63.8 per cent of the dividend receipt for the period 1946-53 compared to the 40.0 per cent for the period 1960-65.

The relationship among dividend receipts from CDIA retained earnings abroad on CDIA, and the outflow of CDIA is a very intricate statistical and decision-making relationship. Various hypothesis could be made and then tested by detailed statistical methods and refined data and by reference to depth case studies on CDIA firms. It would be tempting to conclude that the main reason why the ratio of dividend receipts to CDIA assets has declined from 3.9 per cent in 1954 to 2.4 per cent in 1963 is that the decision-makers in CDIA firms have, on the whole, decided to hold down the size of dividends earned abroad in order to have the desired pool of funds abroad for external expansion as a partial substitute for transferring funds from Canada. One major difficulty with the aggregate statistics is that there are no refined data on retained earnings of foreign located enterprises of CDIA firms; for example the annual increment of CDIA <u>minus</u> the annual outflow of CDIA gives a "messy" residual which may be completely misleading as an index of retained earnings since "other factors" have not been taken out,(such as the changing value of foreign currencies in terms of Canadian funds, the reclassification of portfolio investment in foreign securities as direct investment-the reverse does not seem to be common, and the net entry/exit of firms into/out of CDIA). The drawing of conclusions about investment/dividend decision-making at the micro-level from the available maco-statistics is methodologically hazardous as well. The aggregate statistics are <u>net</u> data, the increment of CDIA in any year, for example, is arrived at (partially) by subtracting the disinvestment of some firms from the investment of other firms. In any one year, the dividend receipts could be accounted for by one group of firms and the outflow of CDIA by another group of firms. There is also the question that in CDIA multinational firms there are wide differences between centralized and decentralized

external dividend and investment decisions: at one extreme would be the case of the foreign subsidiary in which the local management makes the basic decision on the level of its dividend payments to the Canadian parent (and local stockholders, if any) and at the other extreme would be the case where the Canadian parent makes the basic decision.* Thus it would appear that meaningful analysis of firm decision-making with respect to dividend receipts, foreign retained earnings and investment outflows (from the parent company) can best be done by individual firm case studies. This would involve long-run and detailed research.

Aggregate Statistics Relating to Dividend Receipts, Retained Earnings, Investment, and Outflow of CDIA

	Outflow of CDIA $ M			Increment in CDIA $ M		Increment in CDIA Minus CDIA outflow Plus dividend Receipts $ M		Dividend Receipts $ M
1954	90			142		115		63
		-	-		+		+	
1955	85			123		118		80
		+	+		-		-	
1956	105			149		114		70
		-	+		+		+	
1957	80			182		179		77
		-	-		-		-	
1958	40			76		112		76
		+	+		+		+	
1959	85			146		114		83
		-	+		+		-	
1960	50			186		204		68
		+	-		-		+	
1961	80			147		159		92
		+	+		-		-	
1962	105			193		161		73
		+	+		+		+	
1963	135			304		245		76
		-	-		+		+	
1964	95			231		324		188

* Many factors could influence the relevant decision-maker's judgement on the size of dividend receipts in any period: views about the exchange rate, liquidity, interest differentials, exchange controls (potential as well as actual), political stability including the possibility of nationalization, the interaction of tax legislation in Canada and in foreign countries, and the firm's (or the subsidiary's) financing policy.

Canadian Direct Investment Abroad (CDIA) Classified

by Size of Investment, Year Ends 1954 and 1963

While there are probably 350 - 400 (1963) firms located in Canada engaged in CDIA, a relatively few firms account for most of the dollar-value of CDIA.

DBS estimates that the 13 largest firms (in terms of their book-value of CDIA)* accounted for 70.3 per cent of CDIA in 1963. The next 8 largest firms accounted for an additional 7.2 per cent. The next 38 largest firms accounted for an additional 11.5 per cent. The remaining small firms (probably 300 to 350) accounted for the residual (11.0 per cent). Thus, a total of 21 firms accounted for almost 78 per cent of total CDIA and 59 firms for 89 per cent of the total.

CDIA, Classified by Size of Investment, Year End 1963

Book Value of CDIA	No. of firms	Value of CDIA $M	Per cent of total
Over $50M	13	$2,197	70.3
$20 to $50M	8	224	7.2
$5 to $20M	38	358	11.5
Under $5M	n.a.	346	11.0
Totals		$3,125	100.0

Whether or not there has been a significant change in the domestic concentration of control of CDIA since 1954 is difficult to judge. It is impossible to use the total number of firms involved since DBS is quite frank in stating that their coverage is not complete for either 1954 or 1963 and that the degree of coverage for the two years probably varies (1963 being more comprehensive than 1954). For this reason DBS is reluctant to make public the number of known CDIA firms with CDIA under $5 million in 1963.

Even if the 1954 and 1963 comparison is done for those firms with a book value of CDIA over $5 million, the apparent conclusions could be misleading. For example, it is tempting to conclude that firms with CDIA between $20 and $50 million were less important (in terms of several measures) in 1963 than in 1954 and that firms in the over $50 million category and in the $5 million to $20 million category were more important in 1963 than in 1954. One rough measure is the changing percentage shares of CDIA ($5 million or more) of the three groupings of firms: while both the percentage shares of the over $50 million firms and the $5 to $20 million firms increased (74.9 per cent to 79.1 per cent and 10.1 per cent to 12.9 per cent, respectively) the percentage share of the middle sized group of firms, $20 to $50 million, decreased (15.0 per cent to 8.1 per cent). Another rough measure is the changing average (arithmetic) size of the firms in each of the three groupings: while both the average size of the over $50 million firms and the $5 to $20 million dollar firms increased ($137 to $169 million and $8.7 million to $9.4 million, respectively)** the average size of the middle sized group of firms, $20 to $50 million decreased ($37 million to $28 million)**. To conclude from these measures there has been a type of concentration polarization of CDIA economic activity could be most misleading. For instance, since there are so few firms involved in CDIA

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* Throughout this section the definition of "size of CDIA firms" is in terms of the book-value of direct investment outside Canada.

** It is difficult to judge the extent to which 1954 dollars are comparable to the 1963 dollars in constant terms. DBS notes that "book-values" estimates of CDIA are used and as a result in periods of rising prices such values could be less than market values or replacement values

in the $5 million dollar open-ended group (31 in 1954 and 59 in 1963), the influence of three or two (or even one) of the largest firms could largely explain the statistical changes. Furthermore, in the over $50 million group the size of the firms probably covers an extremely wide range (this is indicated by the gap between the $50 million bench-mark and the size of the average firm in the group——$137 million in 1954 and $169 million in 1963). (The rapid expansion of Alcan's CDIA between 1954 and 1963 could, hypothetically, have accounted for a large share of the changes in the two measures noted above for the over $50 million grouping). Furthermore a detailed understanding of the assumptions and definitions used by DBS to calculate the final summary data would be a pre-requisite for drawing meaningful conclusions about any change in the nature of CDIA domestic concentration over the 1954-1963 period

In this latter specific context, the conceptual questions raised earlier have a direct application: if the purpose of analysing concentration and changes in concentration is to gain information pertaining to the concentration of behavioral decision-making control over the use of investment funds, the statistical data may or may not be relevant. For illustrative purposes, it is conceivable that in 1954 two of the firms in the $20 to $50 million category were classified as being separate because of the non-integration of the ownership of their voting stock (they could have had a portfolio exchange of 10 per cent of their stock and still be defined as separate), but which were highly integrated in terms of actual decision making. By 1963, these two firms may have become one legal entity, thereby increasing the number of firms in the over $50 million category (gross) by one and decreasing the number of firms in the $20 to $50 million category (gross) by two. In terms of actual decision-making, it is conceivable that in 1963 there was <u>less</u> integration than in 1954. Assuming this was the only change to take place, it would be completely misleading to conclude from the statistical increase in domestic concentration that actual decision-making concentration had taken place.

CDIA, Classified by Size of Investment $5 Millions and Over, Year Ends 1954 and 1963

Book Value of CDIA	No. of Firms 1954	No. of Firms 1963	Percent of Total* 1954	Percent of Total* 1963	Value of CDIA per firm 1954	Value of CDIA per firm 1963
Over $50M	8	13	74.9	79.1	137	169
$20 to $50M	6	8	15.0	8.1	37	28
$5 to $20M	17	38	10.1	12.9	8.7	9.4
Totals	31	59	100.0	100.1	47.3	47.1

* The total of the three groups with CDIA $5 million or more was 90.5 per cent of the total of all CDIA in 1954 and 89.0 per cent in 1963.

NON-RESIDENT EQUITY AND CONTROL OF CDIA,

particulary 1954-1964

Non-residents have an important share of CDIA through their ownership of equity in firms located in Canada which, in turn, have direct investments abroad. For example, Alcan Aluminium Ltd. (Head Office in Montreal) has 68 per cent of its voting stock held by residents of the United States. It is, therefore, classified as non-resident controlled. Alcan Aluminium, a holding company, has direct investments abroad through its wholly-owned Canadian Company, Aluminium Company of Canada Ltd. The latter company has subsidiaries in the U.S., Italy, Germany, Uruguay, Malaya, Ghana, Australia, Belgium, Spain, New Zealand, Jamaica, Guyana, Brazil, South Africa, France, Argentina, India, Mexico.

DBS, in calculating the non-resident equity in CDIA, seems to start with the percentage of non-resident equity in the 350-400 parent firms located in Canada which have direct investments abroad and then calculates the non-resident equity of the parent firm's direct investments abroad on the basis of the proportion the non-residents have of the equity of the parent firm in Canada. The method used by DBS to calculate the non-resident control of CDIA seems to start with the non-resident control (using the DBS definition) in the 350-400 parent firms located in Canada which have direct investments abroad: if a parent company is classified as controlled by non-residents, then all of its direct investments abroad may be classified as non-resident controlled.

Assuming that the above interpretation of the method used by DBS is correct, it would mean that there are two off-setting influences on the divergence between the ratio of non-resident equity in CDIA and the ratio of non-resident control of CDIA (in 1964, 47 per cent and 43 per cent respectively). One influence tending to make the equity ratio greater than the control ratio is that that non-resident ownership in the Canadian parent CDIA firm which is defined as "portfolio" investment as opposed to "direct investment" results in a proportionate equity share (say, 5 per cent) of the parent company's CDIA while it is not included in the control figure. The opposite influence tending to make the control ratio greater than the equity ratio is that non-resident ownership in the Canadian parent CDIA firm which is defined as "direct investment" (say, 70 per cent equity ownership) results in the total (not just 70 per cent) CDIA of the firm being counted as non-resident controlled while the equity figure has only the original equity proportion (in this case, 70 per cent) counted in.

It should also be noted that if the DBS definition of non-resident control were closer to that of the Taxation Division (25 per cent) the gap between the non-resident equity ratio and the non-resident control ratio would likely be narrower.

Non-residents are calculated to have had $595 million of CDIA equity in 1954 and $1,574 million in 1964, an increase of 165 per cent. During the same period residents had $1,024 million and $1,782 million of CDIA equity respectively, an increase of 74 per cent. Consequently, non-resident ownership of CDIA equity increased from 37 per cent in 1954 to 47 per cent in 1964. (The rate of growth of this ratio was 27 per cent.) This non-resident equity was highly concentrated in the U.S.; 81 per cent of total non-resident equity in 1954 and 82 per cent in 1964. Residents of the U.K., while increasing the dollar-value of their equity in CDIA, accounted for relatively less in 1964 than in 1954. Residents of all other foreign countries increased their relative share between 1954 and 1964.

In terms of the definition of "control" used by DBS, the percentage of non-resident control of the foreign operations of CDIA firms was less than the non-resident "equity" ownership ratios for both 1954 and 1964. In 1954, non-residents through their ownership of equity in firms located in Canada which had direct investments abroad, and control of certain of these firms, controlled 27 per cent of total CDIA. In 1964, this ratio was 43 per cent. (The rate of growth of this ratio was 59 per cent, slightly more than double the corresponding percentage for equity ownership). The

non-resident control while highly concentrated in the U.S., was a slightly smaller share of total non-resident controlled CDIA in 1964 (90 per cent) than in 1954 (97 per cent).

Non-resident Equity and Control of CDIA, 1954 and 1964

A. Equity

	Total CDIA $M	%	(Total Non-resident %)	U.S. %	U.K. %	Other %
1954	1,619	100	(37)	30 *	5	2
1964	3,356	100	(47)	39 *	4	4

B. Control

	Total CDIA $M	%	(Total Non-resident %)	U.S. %	U.K. %	Other %
1954	1,619	100	(27)	26 **	......1.......	
1964	3,356	100	(43)	39 **	......4.......	

* The U.S. share of total non-resident equity was 81.4 per cent in 1954 and 82.4 per cent in 1964.

** The U.S. share of total non-resident controlled CDIA was 97.3 per cent in 1954 and 90.5 per cent in 1964.

What are the explanations of the statistical relative increase in, and control of, CDIA? While very little can be said about the quantitative influence of the various factors at this time, a number of explanations could be possible. First, there is a question of reclassification: residents become non-residents and non-residents become residents. The net result of this between 1954 and 1964 could have increased the non-resident share. Secondly, there is the question of some CDIA parent firms having more of their equity owned by non-residents and other firms have less of their equity owned by non-residents. The net result of this could have been to increase the non-resident equity in CDIA. Thirdly, there is the question of the increase in non-resident equity of a CDIA parent firm resulting in a statistical control transfer from resident to non-resident and vice-versa. The net result of this could have been to increase the non-resident equity in, and control of, CDIA. (If the methodology used by DBS is the one noted above, then the resulting increase in non-resident control of CDIA would tend to be "lumpier" than the increase in the equity ratio.) Fourthly, if the rate of growth in CDIA of non-resident controlled firms (Alcan?) was greater than the rate of growth in CDIA of resident controlled firms, then the net effect would have been to increase the non-resident control ratio of total CDIA: This appears to have been the most important reason for the greater non-resident share in 1964 compared to 1954. Fifthly, the establishment of new firms in Canada to go into the direct investment field by non-residents may have contributed more to the growth of non-resident equity in, and control of, CDIA than similar undertakings by residents. Finally, a foreign company with a direct investment firm in Canada and other direct investments in other countries may have legally transferred the operation of its subsidiaries abroad from its U.S. office to its Canadian subsidiary. (A large new entry with arrangements similar to those of Ford.)

What is the significance, if any, of non-resident equity in, and control of CDIA? What is the significance of the increase since 1954 of the non-resident share of CDIA?

DBS notes that the concept is of significance for calculating Canada's net international investment (indebtedness) position: "In showing Canada's balance of international indebtedness, the equity of non-residents

in the assets abroad of Canadian companies is included in Canadian liabilities in order to offset the inclusion of this equity in the statistics of Canadian direct investments abroad."(3) In this context, the relative increase in non-resident equity in the assets of Canadian companies abroad has been a factor in increasing Canada's international indebtedness.

The significance of the statement that the increase in non-resident control of CDIA has meant less Canadian control of direct investment funds may amount to very little. As noted in the previous section on conceptual difficulties, the classification of non-resident versus resident is a geographical definition rather than a citizenship definition or a behavior (decision-making) definition. For example, there are non-resident Canadian citizens (Weston) with CDIA and there are probably resident non-Canadian citizens with CDIA (International Utilities Corporation?). Conceptually, the relative increase of non-resident potential control of CDIA since 1954 could have been accounted for by Canadian citizens living abroad rather than by foreigners living outside Canada. If this were the correct factual explanation of the relative increase in the non-resident share, the conclusion that Canadians had somehow lost a greater degree of potential control over decision-making pertaining to direct investment abroad, would be erroneous. Take another possible example. Suppose that in 1970 the control of a large Canadian firm with CDIA passed from the hands of a father who was a Canadian citizen and a resident of Canada to the hands of a son who was a naturalized American citizen and resident in the U.S. (Distillers Corporation-Seagrams Limited, hypothetically). In the DBS statistics there would be a lumpy increase in the non-resident equity in, and potential control of, CDIA. In this case, it could be argued that decision-making pertaining to a large portion of CDIA has passed not only from the hands of a resident to a non-resident but also from the hands of a Canadian citizen to an American citizen. But would this latter transfer have any more meaning in terms of decision-making than its definitional meaning (other than the fact that control went from an older person to a younger person)? Would the size of, and location of, the total international investment resources be shifted in any way because of a definitional reclassification? It would seem that hypotheses pertaining to CDIA as economic activity (decision-making) cannot be tested in terms of the aggregate statistics. It might be possible to find some answers to the behavioral questions in terms of specific case studies. And, as Richard Schultz has pointed out in his Appendix (G), the answers may be heavily dependent on the methodology used in the case studies. Conceivably a case study of the type of sequence noted above, could show that after the definitional reclassification, a greater proportion of Canadians held top management positions in the international operation of the firm, for example. But the explanation of this subsequent event need not have anything to do with the reclassification: it might simply be that more of the best people available for top management positions just happened to be Canadian citizens.

Footnotes

(1) D.B.S., *Canada's International Investment Position 1926-1954*, Ottawa: Queen's Printer, 1956, p.48 and a personal letter from Mr. E. B. Carty, Director, Balance of Payments and Financial Flows Division, D.B.S., August 10, 1967.

(2) *Ibid*, p.50

(3) D.B.S., *The Canadian Balance of International Payments in the Post-War Years, 1946-1952*, Ottawa: Queen's Printer, 1953, p.65.

CHAPTER 6

Characteristics of 18 Firms Engaged in CDIA

I

There are between 350 and 400 firms in Canada engaged in CDIA. Eighteen (of an initial list of forty-five) firms have been selected and it is hoped they provide a significant cross section of those firms engaged in CDIA.

All the companies studied are ranked according to sales and net physical assets. This might reflect the importance of said companies in the Canadian economy, enhancing their significance in a study of CDIA, as well as reflecting the importance of CDIA in our economy. All figures are consolidated and as a result, it has been impossible to say how important are foreign subsidiary operations within the consolidated context. However, tables detailing the number of foreign subsidiaries as well as their geographical distribution might shed some light on this area.

In a more behavioural sense, it is hopeful that we might be able to isolate some factors which are peculiar to those firms that indulge in CDIA, i.e., the move towards vertical or horizontal integration. Of crucial importance is the question whether a decision to locate is based on rational decision-making policy, i.e., do these firms carry out effective research into areas in which they hope to invest, or are they, as is suspected, a personal decision at the whim of the president of the company. These two references are specifically at the opposite ends of the scale. Often, the answer lies between these two limits. Both, however, are possible.

Is there any inherent quality within the firm that leads it to undertake direct investment? Some obvious answers can be outlined. If the firm is large enough, it can no longer expand within the bounds of its own industry in a domestic setting. To maintain its rate of growth, it will expand into foreign markets (assuming tariffs are a barrier to exporting). Is the firm an "international" entity? If so, this would explain its direct investment. What role does the product of the firm play? A liquor manufacturer would be relatively small scale if he produced only for the domestic market, as would an agricultural implements manufacturer. However, a pipeline or utility company, would be unusual if its main aim was direct investment.

Of importance is the question of resident vis-a-vis non-resident control. Would a firm which is non-resident controlled be more likely to undertake foreign investment than a resident Canadian firm? This is the type of question we will deal with in this section.

II

Before discussing the actual profiles, it is necessary to qualify what follows. A discussion of the sources used in writing the profiles, the goals of the profiles as well as their limitations, is in order.

The primary sources were the Financial Post card profiles on the firms and the published financial statements sent by the respective firms. The Financial Post Surveys of Directors, Mines, Oils and Industrials (4 distinct magazines) were used. The Toronto Central Library provided files of newspaper clippings on many Canadian companies. The Canadian Periodical Index was used to trace any articles relevant to the profiles. Such magazines as the Monetary Times and Maclean's magazine were among those used. Various investment brokerage firms sent profiles and financial information they had compiled on the firms being studied. The Harvard Business School sent a case study done on Massey-Ferguson.

The profiles have the following sub-headings:

1. The Corporate Structure of the Parent
2. Indicators of Firm's Importance Within the Industry
3. History and Operations of Subsidiaries and Associated Companies
4. Intra-Enterprise Relationships
5. Location of Industry

A discussion of these sub-headings will outline the intended goals of using the profiles.

1. The Corporate Structure of the Parent

An examination of the corporate structure was intended to throw light on two areas: first, the ownership distribution on both a geographical and group or individual basis; secondly, the role played by the management personnel on the boards of the companies concerned. It was also thought that this section might reveal something of the management "philosophy" of the concern which would be valuable in understanding and evaluating parent-subsidiary relations in later sections (Intra-Enterprise Relationships).

2. Indicators of Firm's Importance Within the Industry

How significant is the firm within the national economy as reflected in an examination of the consolidated sales, profit and fixed asset figures? A comparison between 1954 and 1964 would show any shift in their relative importance. In some cases, depending on the characteristics of the industry, these comparisons might reflect the growing importance of that firm's CDIA, in relation to the firm's overall growth. For example, an established beverage manufacturer doubles his sales between 1954 and 1964. Unless it has absorbed its national competition, such an increase in sales might be indicative of direct investment, i.e., the purchase of a foreign subsidiary.

3. History and Operations of Subsidiaries and Associated Companies

This section provides factual data on the location and industrial classification of the foreign subsidiaries and associated companies. Where dates and figures are available they might explain the relative geographic shift of CDIA over time. They might also reflect why such a shift has taken place.

4. Intra-Enterprise Relationships

This section, the one for which there is the least information, might reflect any evidence of parental control and its extent over the operations of the subsidiary. For example, it would reveal if there are associated costs such as the export of management or technical labour as well as the export of capital in a direct investment situation. This might also reflect the degree of integration within the firm.

5. Location of Industry

This section is for the most part speculative in nature and content. Its purpose is to open up the question of why firms locate to further discussion.

There are glaring shortcomings in the profiles and it would be misleading if the impression left by them was anything but questioning. An outline of these limitations might qualify their acceptability.

1. The lack of uniform data limits any meaningful comparison between the firms studied.

2. The different characteristics of the firms, i.e., larger fixed assets, inhibit the possibility of making too meaningful comparisons. An example will clarify this point. One cannot really compare the direct investment of two firms on the basis of fixed assets because, in the case of a beverage industry, its fixed assets investment would be small relative to that of a utility or pipeline. On the other hand, the comparability of their respective sales figures might yield exactly the opposite.

3. The fact that few dates for the establishment of foreign subsidiaries are available, indicates that geographic shifts in CDIA over time cannot be measured.

4. Direct investment figures for each company are not available so one cannot measure quantitatively the significance of the 18 firms in total CDIA. This reflects the inability to state that these 18 firms represent a significant portion of total CDIA. In fact, they might not be significant.

5. Some firms, such as Robert Morse Corporation, assumed their present form and policies after 1954; therefore comparisons for the period 1954 to 1964 are meaningless. This negates the comparability of Robert Morse to another firm over the same period.

6. The purpose of the profiles was to present only information about the firm that might reflect some light on their reasons for locating abroad. The sources used were by no means exhaustive and it is possible that some misinterpretation of the firm and its policies has taken place. This is especially true in the area of control, i.e., control in the parent and how extensive is parent involvement in the operations of subsidiary companies.

III

The sections that follow should be read bearing in mind the aforementioned limitations. What follows is based on the tabular information located at the end of the chapter.

A look first at the macro-evidence compiled in the charts on the geographical distribution of foreign subsidiaries of CDIA firms (1966) in the eighteen firms studied. Between them, the seventeen firms had 151 subsidiaries in which at least a 50 per cent interest was held and 24 companies in which they held less than a 50 per cent interest. Needless to say, the companies studied have an affinity for holding in excess of 50 per cent of the stock of their subsidiaries.

The geographic distribution of those subsidiaries was:

TABLE

	Total 151	50% or more	Total 24	Under 50%
United States		28.5		4.2
United Kingdom		14.0		8.4
Latin America		12.6		20.8
Other America		9.3		-
Africa		6.6		4.2
Common Market		12.5		4.2
Other Europe		6.6		29.0
Australasia		7.3		8.4
Asia		2.6		20.8
		100.0		100.0

Several trends may be culled from the above table. First, among the subsidiaries which are in excess of 50 per cent owned, 23.5 per cent of those subsidiaries are located in the United States; 61.6 per cent of the subsidiaries are located in the United States and Europe. The existence of well-established markets and less risk accruing from the existence of political stability in these areas may explain the extent of subsidiaries located in these areas.

Virtually all the companies examined in the profiles had at least one subsidiary in the United States in which it held in excess of 50 per cent of the voting stock. The very sizeable companies had more than one subsidiary in the United States (Alcan, Massey-Ferguson, MacMillan-Bloedel, Cominco, Moore Corporation, etc.).

The same is not true in the case of subsidiaries in the United Kingdom. Only ten of the seventeen companies had subsidiaries in the United Kingdom and of those, four had in excess of one subsidiary there. They are Alcan Aluminium Ltd., Massey-Ferguson (both acknowledged "international" companies), MacMillan-Bloedel and Distillers Corporation-Seagrams Limited. The latter has diversified within its own industry in that it acquired a scotch whisky plant in Scotland and a gin plant in England. It has its own whisky distributed through the third subsidiary for the British market. In this respect, it has become vertically-integrated within the alcoholic beverage industry.

Alcan, Massey-Ferguson and Polymer Corporation are all prominent in the Common Market area probably because of the external tariff (all are involved significantly in the production of manufactured goods, the items which are most heavily subject to tariffs).

The same three firms make up the 6.6% of subsidiaries (over 50 per cent) in "Other Europe" for reasons similar to those mentioned above.

The remaining 38.4 per cent consists of 12.6 per cent in Latin America (mainly Alcan, Massey-Ferguson and Distillers Corporation-Seagrams Limited), 9.3 per cent in Other America (principally Alcan, Salada Foods, and Massey-Ferguson, in that order). Alcan and Massey-Ferguson are the main companies having CDIA in Africa, Australasia and Asia, where the ownership of the subsidiary is in excess of 50 per cent.

Interestingly the geographical distribution of the subsidiaries which are less than 50 per cent owned is different. Only 4.2 per cent was in the United States and only 46 per cent was in the United States and Europe, in the companies studied. The 4.2 per cent in the United States was exclusively Husky Oil Limited which is a non-resident Canadian corporation. Since its owners are American citizens it would not be unusual to enter a joint venture.

In the United Kingdom, Canadian Breweries and Moore Corporation each have one associated company* in which they own less than 50 per cent of the voting stock.

The only significant prevalence of associated companies in the U.S. and Europe is 29 per cent under "Other Europe". This is made up principally of the five associated companies of Alcan in Scandinavia. It is known that countries such as Sweden and Norway have taken positive steps to prevent foreign ownership of their industries. It is therefore likely that the only way Alcan could gain access to these countries was to enter joint ventures in the respective countries. This might explain, for that matter, the existence of associated companies, a compromise between direct investment and licensing.

20.8 per cent of the associated companies in this study were located in Latin America; Massey-Ferguson was involved in

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* Associated company is the term used to refer to a subsidiary in which the parent owns less than 50 per cent of the voting stock.

two such companies, and the rest (Alcan, Polymer and Moore Corporation) in one.

Only one such company was found in Africa, again associated with the Polymer Corporation.

8.4 per cent or two associated companies were located in Australia, both associated with Alcan Aluminium Limited.

20.8 per cent of the associated companies were located in Asia. Note the opposite was true in the case of subsidiary companies (only 2.6 per cent of those subsidiaries found were located in Asia). The marked existence of significantly and relatively more associated companies in Asia reflects several important facts about direct investment vis-a-vis portfolio investment*.

There is a preference to invest in politically stable areas. All the more so in direct investment than portfolio investment, as the initial capital expenditure is greater. Many countries in non-communist Asia today do not present the picture of political stability. India and Japan are exceptions.

All the associated companies, that is the 20.8 per cent located in Asia, were in Japan. Japan, as does Sweden, has laws preventing the establishment of wholly-owned subsidiaries and branch plants. These countries nevertheless open the door to associated ventures. The companies in this study, located in Japan are Alcan (1), Massey-Ferguson (1), Cominco (2) and Moore Corporation (1).

The statistics forthcoming from this study (noting the limitations) imply that associated companies, for the most part, are a result of active legislation on the part of the host country, favouring the establishment of joint ventures and preventing direct investment.

IV

A more specific look at one firm, Alcan, may help to complement the aggregate data on geographical distribution of the subsidiaries of the firms studied.

Alcan Aluminium Limited

In terms of fixed assets, Alcan, of all firms studied, ranked first in 1954 as well as in 1964. The mining of bauxite as well as the manufacture of aluminum require sizeable capital equipment investments. Alcan's net fixed assets increased from $611 million to $951 million between 1954 and 1964. As reflected in the size of its net fixed asset holdings in 1954, Alcan was a well-established firm by that date. The growth in its net fixed assets over the period was 56 per cent.** Because it was well-established in 1954, it is doubtful that its growth in fixed assets over the decade was due to the company's growth within Canada alone. We might even speculate that the more significant part of that growth was due to an increase in the company's CDIA. The fact that Alcan is an "international company" upholds this view. A look at the sales figures for the period further substantiates this opinion.

Canada provides a well-defined and ever-growing market for aluminum. Although Canada is in a state of economic growth,

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* Associated companies are classified according to DBS statistics as portfolio investment.

** Net fixed assets are equal to gross fixed assets less depreciation. Therefore the actual increase in fixed assets over the period is equal to net fixed assets (1964) - net fixed assets (1954) plus the depreciation taken during the ten year period, which may or may not result in a different growth rate.

its gains have not been so spectacular as to be able to absorb a 122% increase in sales of aluminum by Alcan during the decade 1954 to 1964. One might be safe then to assume that an important role in Alcan's growth in the decade 1954 to 1964 was due to its increasing CDIA.

The logical question is where has Alcan invested its CDIA and has it changed over the decade. Unfortunately, 1954 figures were unavailable but a comparison of the distribution of employees between 1956 and 1964, might be helpful.

	1956		1964	
Total	47,627	% Total	51,541	% Total
Canada		47.2		32.7
Africa		2.7		3.1
Asia (mainly India)		7.2		9.6
Caribbean		14.0		15.5
Europe		8.0		9.9
South America		4.8		10.6
United Kingdom		15.3		13.0
United States		.4		1.4
Other (Oceania)		.02		4.2
		100.0		100.0

During the period 1956 to 1964 the relative number of employees within Alcan increased at a time when the relative number of Canadian employees decreased from 47.2 per cent of the total to 32.7 per cent of total. The number of employees in South America increased significantly, from 4.8 per cent to 10.6 per cent of total. Further, the increase of employees in Oceania increased from a negligible figure in 1956 to 4.2 per cent of total in 1964. Although in the United States the number of Alcan employees has trebled, its relative increase in terms of the size of Alcan has increased from only .4 per cent to 1.4 per cent of total employees. Alcan's evidently sizeable investments in South America and Oceania might account for the relative shift of CDIA away from the United States between 1954 and 1964.

V

A discussion of the ranking of the firms (see end of chapter) according to level of sales and net fixed assets in 1954 and 1964 might reveal the type of firm which would partake in CDIA. The growth in sales might be cross checked against the growth in fixed assets, the actual rate of growth being, in all likelihood, somewhere between these two figures.

According to sales, Distillers Corporation-Seagrams Limited ranked first in both 1954 and 1964. It ranked only twelfth in terms of its growth rate because of the very high level of sales initially in 1954 ($753 million). Hiram Walker-Gooderham & Worts Limited dropped from second position in 1954 to fourth in 1964. Alcan maintained its third position throughout the period. Massey-Ferguson, which held the fourth position in 1954, jumped to second in 1964. Its rate of growth in sales ranked third among those firms studied. Sales increased 159 per cent. MacMillan-Bloedel maintained its rank in fifth position over the period.

On the basis of sales, little significant change has taken place aside from Massey-Ferguson.

The two companies with the greatest growth rate in sales were Consumers' Gas at 496.3 per cent and Husky Oil at 419.5 per cent. The former is due to the company's growing role in the Ontario market for natural gas and therefore does not concern us here. The latter is due to a program of rapid expansion especially into retail areas and also principally in Canada.

The changes in net fixed assets are somewhat more dramatic. Alcan Aluminium Limited maintained its position as the leader, among those firms studied, throughout the period. Interprovincial Pipe Line Company dropped from second position in 1954 to fifth in 1964, due mainly to the fact that its capital expenditure program has decelerated after the initial five years of the company's operations (1949-1954). Third position was maintained throughout the period by MacMillan Bloedel. Cominco held the fourth position in 1954 but fell to eighth in 1964. Distillers Corporation-Seagrams Limited also dipped from fifth in 1954 to seventh in 1964. Consumers' Gas came up to fourth position in 1964 from sixth in 1954. The most dramatic change was that of Massey-Ferguson which jumped from eighth position in 1954 to second in 1964. Its rate of growth of fixed assets over the period was 799 per cent, third after Canadian Breweries (813 per cent) and Husky Oil Canada Ltd. (1251.6 per cent). Canadian Breweries as well as Massey-Ferguson undertook sizeable foreign investment programs throughout this period (see individual firm profiles).

Name of Parent (ranked by net physical assets 1964)	Total Number Foreign Subs.	U.S.	U.K.	Latin America	Other America	Africa	Common Market	Other Europe	Australasia	Asia
Alcan Aluminium Limited	40	3	2	6	6	4	5	6[a]	5	3
Massey-Ferguson Limited	35	4[a]	7	6	2	4	7	2	3	-
MacMillan Bloedel Limited	9	5[c]	3	-	-	-	-	-	1[a]	-
The Consumers' Gas Company	1	1	-	-	-	-	-	-	-	-
Interprovincial Pipe Line Company	1	1	-	-	-	-	-	-	-	1[a]
Canadian Breweries Limited**	4	1	1	-	1	-	-	-	-	-
Distillers Corporation-Seagrams Limited**	10	5	3	2[a]	-	-	-	-	-	-
Cominco Ltd.	6	3	1[a]	-	-	-	1[a]	-	1[a]	-
Husky Oil Canada Ltd.	6	5	-	-	-	1	-	-	-	-
Polymer Corporation Limited	6	-	-	-	-	-	4[a]	2[a]	-	-
Hiram Walker-Gooderham & Worts Limited**	6	3	1	1	1	-	-	-	-	-
Moore Corporation, Limited	6	4	-	1	1	-	-	-	-	-
Fraser Companies, Limited	1	1	-	-	-	-	-	-	-	-
Salada Foods Ltd.	7	1	1	1	3	-	1	-	-	-
Robert Morse Corporation Limited	7	2	1	1	-	1	1	-	1	-
Crush International Limited	5	3	1	1	-	-	-	-	-	-
Harvey Woods Limited	1	1	-	-	-	-	-	-	-	-
Canadian Pacific Railway Company***	-									
Total	151	43	21	19	14	10	19	10	11	4
%	100.0	28.5	14.0	12.6	9.3	6.6	12.5	6.6	7.3	2.6

(a) One of these was acquired or established after 1964
(b) Two of these were acquired or established after 1964
(c) Three of these were acquired or established after 1964

* In which the parent has a 50% or more interest
** This figure includes production plants listed under "Brand Names".
The same classification applies to Hiram Walker and Canadian Breweries.
*** C.P.R. direct investment cannot be listed according to foreign subsidiaries.

GEOGRAPHICAL DISTRIBUTION OF EQUITY INVESTMENT IN OTHER COMPANIES* BY CDIA FIRMS, 196[illegible]

Name of Parent (ranked by net physical assets 1964)	Total Number Other Companies	U.S.	U.K.	Latin America	Other America	Africa	Common Market	Other Europe	Australasia	Asia
Alcan Aluminium Limited	10	-	-	1	-	-	1	5	2	1
Massey-Ferguson Limited	4	-	-	2(a)	-	-	-	1(a)	-	1
MacMillan Bloedel Limited	1	-	-	-	-	-	-	1(a)	-	-
The Consumers' Gas Company	-									
Interprovincial Pipe Line Company	-									
Canadian Breweries Limited	1	-	1	-	-	-	-	-	-	-
Distillers Corporation-Seagrams Limited	-									
Cominco Ltd.	2	-	-	-	-	-	-	-	-	2(b)
Husky Oil Canada Ltd.	1	1(a)	-	-	-	-	-	-	-	-
Polymer Corporation Limited	2	-	-	1(a)	-	1(a)	-	-	-	-
Hiram Walker-Gooderham & Worts Limited	-									
Moore Corporation, Limited	3	-	1	1(a)	-	-	-	-	-	1(a)
Fraser Companies, Limited	-									
Salada Foods Ltd.	-									
Robert Morse Corporation Limited	-									
Crush International Limited	-									
Harvey Woods Limited	-									
Canadian Pacific Railway Company	-									
Total	24	1	2	5	-	1	1	7	2	5
%	100.0	4.2	8.4	20.8	-	4.2	4.2	29.0	8.4	20.8

(a) Interest in one of these was acquired or established after 1964
(b) Interest in two of these was acquired or established after 1964

* In which CDIA firm has less than 50% interest.

RANKING OF CDIA FIRMS STUDIED BY NET SALES, 1954 AND 1964

(Thousands of Dollars)

	1954		1964	
Name of Firm	Sales	Rank	Rank	Sales
Distillers Corporation-Seagrams Limited	$752,692	1	1	$897,083*
Hiram Walker-Gooderham & Worts Limited	339,286	2	4	498,174*
Alcan Aluminium Limited	298,083	3	3	662,424
Massey-Ferguson Limited	297,700	4	2	772,000
MacMillan Bloedel Limited	212,591	5	5	413,309
Canadian Breweries Limited	161,383	6	6	412,306
Moore Corporation, Limited	89,031	7	7	214,629
Polymer Corporation Limited	53,228	8	9	113,864
Fraser Companies, Limited	50,337	9	14	64,844
Robert Morse Corporation Limited	31,500	10	13	69,422
Interprovincial Pipe Line Company	29,583	11	12	74,983
The Consumers' Gas Company	13,482	12	11	80,395
Husky Oil Canada Ltd.	9,725	13	15	50,524
Cominco Ltd.	-	-	8	170,029
Crush International Limited**	-	-	-	-
Harvey Woods Limited	-	-	16	9,638
Salada Foods Ltd.	-	-	10	82,000
Canadian Pacific Railway Company***	-	-	-	-

* These firms express their Net Sales figures in terms of U.S. dollars. The difference will be ignored for purposes of this ranking.

** No figures are available

*** Figures are not comparable

RANKING OF CDIA FIRMS STUDIED BY NET SALES, 1954 AND 1964

(Thousands of Dollars)

Name of Firm	1954 Sales	1954 Rank	1964 Rank	1964 Sales
Distillers Corporation-Seagrams Limited	$752,692	1	1	$897,083*
Hiram Walker-Gooderham & Worts Limited	339,286	2	4	498,174*
Alcan Aluminium Limited	298,083	3	3	662,424
Massey-Ferguson Limited	297,700	4	2	772,000
MacMillan Bloedel Limited	212,591	5	5	413,309
Canadian Breweries Limited	161,383	6	6	412,306
Moore Corporation, Limited	89,031	7	7	214,629
Polymer Corporation Limited	53,228	8	9	113,864
Fraser Companies, Limited	50,337	9	14	64,844
Robert Morse Corporation Limited	31,500	10	13	69,422
Interprovincial Pipe Line Company	29,583	11	12	74,983
The Consumers' Gas Company	13,482	12	11	80,395
Husky Oil Canada Ltd.	9,725	13	15	50,524
Cominco Ltd.	-	-	8	170,029
Crush International Limited**	-	-	-	-
Harvey Woods Limited	-	-	16	9,638
Salada Foods Ltd.	-	-	10	82,000
Canadian Pacific Railway Company***	-	-	-	-

* These firms express their Net Sales figures in terms of U.S. dollars. The difference will be ignored for purposes of this ranking.

** No figures are available

*** Figures are not comparable

RANKING OF CDIA FIRMS STUDIED BY GROWTH RATE IN NET SALES, 1954-1964

Name of Firm	Rank	Growth Rate (%)
The Consumers' Gas Company	1	496.3
Husky Oil Canada Ltd.	2	419.5
Massey-Ferguson Limited	3	159.3
Canadian Breweries Limited	4	155.5
Interprovincial Pipe Line Company	5	153.5
Moore Corporation, Limited	6	141.1
Alcan Aluminium Limited	7	122.0
Polymer Corporation Limited	8	113.9
MacMillan Bloedel Limited	9	94.0
Hiram Walker-Gooderham & Worts Limited	10	46.8
Fraser Companies, Limited	11	29.0
Distillers Corporation-Seagrams Limited	12	19.2
Cominco Ltd.*	-	-
Harvey Woods Limited*	-	-
Crush International Limited*	-	-
Salada Foods Ltd.*	-	-
Robert Morse Corporation Limited*	-	-
Canadian Pacific Railway Company**	-	-

* Growth rates cannot be calculated because figures are not available.

** Figures not comparable.

RANKING OF CDIA FIRMS STUDIED BY VALUE OF FIXED ASSETS, 1954 AND 1964

(Thousands of Dollars)

Name of Firm	1954 Fixed Assets	1954 Rank	1964 Rank	1964 Fixed Assets
Alcan Aluminium Limited	$610,543	1	1	$951,199
Interprovincial Pipe Line Company	210,883	2	5	224,125
MacMillan Bloedel Limited	103,294	3	3	272,944
Cominco Ltd.	83,117	4	8	96,461
Distillers Corporation-Seagrams Limited	44,818	5	7	137,000
The Consumers' Gas Company	34,267	6	4	243,349
Hiram Walker-Gooderham & Worts Limited	33,341	7	11	60,785
Massey-Ferguson Limited	30,700	8	2	276,000
Polymer Corporation Limited	30,582	9	10	61,870
Fraser Companies, Limited	23,091	10	13	33,152
Canadian Breweries Limited	17,530	11	6	159,977
Moore Corporation, Limited	12,709	12	12	53,860
Husky Oil Canada Ltd.	5,301	13	9	71,650
Harvey Woods Limited	2,386	14	17	1,374
Crush International Limited	1,494	15	16	3,840
Salada Foods Ltd. *	-	-	14	15,000
Robert Morse Corporation Limited *	-	-	15	4,083
Canadian Pacific Railway Company **	-	-	-	-

* No figures are available for 1954.

**C.P.R. figures are not really comparable as they are based on "Property Investment". In 1954, the value of "Property Investment" was $1,694,213,032 and in 1964 it was $1,358,514,000.

RANKING OF CDIA FIRMS STUDIED BY GROWTH RATE IN VALUE OF FIXED ASSETS, 1954-1964

Name of Firm	Rank	Growth Rate (%)
Husky Oil Canada Ltd.	1	1251.6
Canadian Breweries Limited	2	812.6
Massey-Ferguson Limited	3	799.0
The Consumers' Gas Company	4	610.2
Moore Corporation, Limited	5	328.8
Distillers Corporation-Seagrams Limited	6	205.7
MacMillan Bloedel Limited	7	164.0
Crush International Limited	8	157.0
Polymer Corporation Limited	9	103.3
Hiram Walker-Gooderham & Worts Limited	10	82.3
Alcan Aluminium Limited	11	56.0
Fraser Companies, Limited	12	44.0
Cominco Ltd.	13	16.1
Interprovincial Pipe Line Company	14	6.3
Harvey Woods Limited	15	-42.4
Salada Foods Ltd.*	-	-
Robert Morse Corporation Limited*	-	-
Canadian Pacific Railway Company**	-	-

* Growth rates cannot be determined because 1954 figures not available.

** Figures not comparable.

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CHAPTER 7

Observations on Why 18 Firms have Engaged in CDIA and Their Choices Between CDIA, Exports, Licensing and Portfolio Investment

I

The 18 CDIA firms for which profiles have been done appear to have engaged in CDIA for a number of reasons. Any given decision usually rests on a multitude of reasons, the net effect being to choose over exports, licensing, or portfolio investment* to generate foreign earnings.

This chapter will utilize two methods to discuss the importance of various factors affecting the decision to engage in various methods of generating foreign revenue, with particular emphasis on the choice of CDIA. The first method will be to discuss the factors in isolation, citing examples from the firms studied where possible. The second method is to examine a number of the firms in terms of the various factors which influenced their decisions. Where possible, an attempt will be made to underline what appears to be the key to the major determinant.

II

The desire to gain a reliable and continuing source of a factor input could be a major reason for a firm located in Canada to engage in CDIA. Alcan, for example, has direct investment in bauxite mines in Guyana, Jamaica, France and several other countries. The decision to enter into direct investment rather than relying on long-term import contracts may have been based on the assumption that competitors would move in with direct investment and tie up the known supplies and production of bauxite. It would appear that because of a relative scarcity of bauxite and the resultant need to stockpile this raw material in order to assure a continuous inflow of it, Alcan has decided that the greatest long-run profit can be derived from having ownership of the sources of supply in foreign countries.

The existence of a prohibition against specific imports by a foreign country is another reason for choosing direct investment rather than exporting. Mexico apparently does not allow rum to be imported and, accordingly, Distillers Corporation-Seagrams Limited established a CDIA enterprise in Mexico for the production of rum.

The existence of tariffs is often given as an important factor in influencing a firm to engage in CDIA rather than exporting from Canada. This was one of the reasons for Polymer's decision to build synthetic rubber plants inside Common Market countries.

Other cost factors are important as well, such as high transportation costs of bulky products, lower foreign manpower costs for certain types of manpower needs. Such cost factors would appear to have played an important role in Alcan's decision to locate direct investment enterprises in the Common Market countries. The same cost factors also appear to have been critical in Massey-Ferguson's decision to locate in Europe.

The desire to create greater foreign effective demand for a product manufactured in Canada may also be an important consideration. The U.K. subsidiaries of MacMillan Bloedel, for example, purchase linerboard produced at MacMillan Bloedel's British Columbia plant. It is important, however, to note the danger of such generalizations and this is pointed out by the fact that the U.K. firms purchased linerboard from the B.C. plant <u>before</u> they were acquired by MacMillan Bloedel.

Another reason for a firm deciding to engage in direct investment is to maintain its sales in a particular foreign country. A Canadian firm which is exporting to a particular country may believe that a competitor is about to establish a plant in that country in order to become more competitive in that

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* For the purposes of this section, we will rely on the DBS distinction between direct investment (50% or more except in a few cases) and portfolio investment (less than 50%).

market. The Canadian firm, as a consequence, may decide to establish its own production facilities in that country to replace its own exports rather than having a competitor do so. This line of reasoning appears to have been a factor in some of the investment decisions of Alcan, at least in its non-mining activities, Massey-Ferguson, and Polymer.

Another factor that no doubt will influence a firm's decision to choose CDIA rather than licensing or portfolio investment is the relatively limited financial return. Myers has pointed out that "the results are often less than 5% on sales. Management may be unwilling to invest the time and effort involved for such low returns."(1) The return on portfolio investment would be similarly limited through the percentage of ownership, all other things being equal.

Another possible reason for the choice of CDIA rather than exporting or licensing or portfolio investment is suggested by the Royal Commission on Taxation which states in "Part D, International":(2)

> By establishing companies in jurisdictions which impose little or no tax, Canadians can reduce their Canadian tax by engaging in a series of paper transactions which exploit the provisions of tax treaties...

The type of situation suggested by the Commission is illustrated by the Polymer Corporation. Polymer established Polysar International in Switzerland with the responsibility for marketing Polysar products in all international markets. By so doing, rather than having the Canadian parent or other subsidiaries handle all exports, Polymer diverts its sales profits into Switzerland where the tax rate is about 18 per cent. Such profits otherwise would be taxable in Canada at 52 per cent.

A major factor that conditions a firm's choice particularly between direct investment and licensing is the fact that licensing ordinarily involves processes or products that are patented or carry trade-marks. Thus unless a firm has such specialties, licensing is not an alternative. In the case of Canadian Breweries, with its Black Label beer, licensing is possible. In the case of Moore Corporation, with its specialty machines for business form production, licensing is possible. In the case of Alcan, unless it has such a specialty, which would appear doubtful in view of the nature of the products, licensing is not an option. Moreover, even if it was, it would probably be applicable only to a limited part of Alcan's (or Massey-Ferguson's) total operation and, thus, the market for its other products would not be utilized. In the case of Polymer, which does involve a highly complex operation, licensing could be an alternative except for the fact that the process is so complex it would be difficult to establish a workable licensing arrangement.

III

Thus far, the discussion has centred on factors that favour the choice of CDIA over licensing, exporting or portfolio investment as a means of generating foreign revenue. There are factors, however, that favour the latter methods at the expense of CDIA.

One such factor is government restrictions on the extent of interest in firms that can be owned by foreign concerns. Some countries do not allow foreigners to establish or participate in enterprises in which more than a 50 per cent interest rests with foreigners. Such is the case in Japan and several countries in the Outer Seven in Europe. Hence Cominco's and Moore's investment in joint ventures in Japan. It should be noted here that it is in such joint ventures that the crucial problems of defining "control" arise.

In some situations foreign governments limited the degree of outside ownership in particular industries. Such is the case with Polymer's investments in Mexico and South Africa which resulted from the expressed desire of the governments of these countries to have "internal" supplies of synthetic rubber.

Another factor that limits the range of choice between various methods of generating foreign revenue is scarcity of capital. The experience of Harvey Woods is a case in point. Harvey Woods originally had an American subsidiary producing hosiery for the American market. In 1954, however, the

Canadian firm incurred heavy losses and, as a result, was not capable financially of maintaining its American operation and accordingly changed from processing to licensing.

IV

Sections II and III above discuss some of the major factors that influence the choice of alternative methods available to a firm for generating foreign revenue. The factors, however, have been discussed in isolation as they relate to particular firms studied. The purpose of this section is to present several examples of situations drawn from the firm profiles where the various factors are interrelated.

Moore Corporation presents an interesting example of the various factors that can influence a firm's decision on how to expand internationally. In the case of its American subsidiaries, primarily those in the equipment and machinery fields, the choice of direct investment through wholly-owned subsidiaries was based on Moore's concern with its highly integrated operation that has resulted in technological advantages over its competitors. Accordingly, Moore wishes to remain self-sufficient in order to protect its position.

Moore's "willingness" to engage in joint ventures, however, suggest several other important factors. Moore has established the joint venture with the Japanese concern to form Toppan-Moore Business Forms partly because of the government restrictions in that country mentioned above. However, it is also highly likely that because of the apparent strength of Toppan itself in Japan (Toppan is reported to be a major Japanese printer), Moore could not expand into Japan through association with independent Japanese investors. Moreover, Moore also established a technical and licensing agreement with the new firm to share some of its industrial secrets with it. Of importance to the analysis of Moore's decision to engage in a joint venture is that despite the restrictions, Moore has a major foothold in an industrialized market which is largely untouched.

Moore's joint venture with a printing firm in San Salvador illustrates another factor influencing the nature of investment. Again, it is highly likely that such a method was necessary because of possible tariff restrictions that will be established by the new Central American Common Market which the joint venture will serve. However, perhaps of more importance to Moore's decision to invest is the fact that, unlike Japan which is an industrialized but yet relatively untouched market, the Central American market is still basically limited because the area is presently industrializing. Accordingly, it is doubtful that the market could have supported a wholly-owned company-operated activity. This fact, plus the factor of risk which is intensified in this region, no doubt influenced Moore's decision.

Alcan Aluminium Limited has used direct investment to achieve vertical integration whereby the firm, because it provides its own raw materials for its production centres to be marketed by its own distributing and sales organizations, is self-contained and, hence, self-sufficient. Alcan builds its raw material reserves by mining bauxite wherever it may be competitively available -- Jamaica, Guyana, Malaysia.

Distillers Corporation-Seagrams Limited (DC-SL) also illustrates the importance of various factors in influencing a firm's decision as to how it should go abroad. The Mexican government prohibits the importation of rum; therefore, DC-SL cannot export rum from its plant in Jamaica to Mexico. Accordingly, DC-SL has a plant to manufacture rum within Mexico. The question to be asked is why DC-SL has resorted to direct investment rather than a licensing arrangement with a firm in Mexico. There are two explanations that are not mutually exclusive. In the first instance, there is the question of quality. Company representatives have stated that licensing arrangements are incompatible with the nature of DC-SL's products. Tight control over production abroad is needed to ensure the quality of the product. The quality of the product is not determined simply by its immediate production for it has to remain in storage for some time. Thus, there could be a lag of at least ten years between the production of the alcoholic beverage and its sale. As a result, since most licensing arrangements are made for a limited period of time, DC-SL considers licensing an unacceptable alternative to direct investment. Presumably, the fact that such a production process is not one that rapidly generates revenue, impatient minority stockholders in host countries are also to be shunned.

However, as C. H. Lee has pointed out, it is possible to avoid the problems feared by DC-SL by including appropriate terms within the licensing agreement to ensure things such as quality of product. Thus it is highly probable that DC-SL has rejected licensing (and joint ventures) because of the highly personalized and centralized management of the parent. In brief, the Bronfmans have no great desire to share the direction of the company's operations or its profits with outsiders.

V

The examples discussed above are by no means exhaustive in suggesting factors that will influence a firm's decision to choose direct investment rather than other forms of generating foreign earnings, such as joint ventures, licensing or exporting. One factor that has not been mentioned, except implicitly, is what Lee describes as the firm's "desire to control its own destiny".(3) Both Myers and Lee suggest that a major reason for the choice of direct investment is the fact that the establishment of subsidiaries brings with it, for the parent company, control over the subsidiaries' operations. Neither Myers or Lee, however, indicate at what minimum level of ownership is control established. It is not the intention here to reopen the debate that forms the central part of Chapter 4, Some Conceptual Problems and Limitations. However, the issue is such that it merits discussion as it relates to the factors affecting the choice of generating foreign revenues.

The example of DC-SL cited above illustrates concretely the desire for "control over quality" of the products. The example of Alcan suggests the desire for control over raw materials to ensure the self-sufficiency of the firm. Measures taken by Moore, particularly with respect to the machinery plants, suggest the desire on Moore's part to have control over its industrial secrets to maintain its competitive advantages.

Moreover, perhaps one of the main reasons for direct investment as it relates in part to the question of control over some aspects of foreign operations is that, all other things being equal, direct investment more than licensing or joint ventures provides maximum financial benefit for the firm. As stated above, licensing brings in returns of only 5-10%; joint ventures divides the returns according to the percentage division of ownership. Direct investment (primarily, that is, where the subsidiary is wholly-owned) insures a maximum financial benefit to the parent company. In other words the "pie of foreign investment" is not shared, at least to the extent it would be with licensing or joint venture arrangements. This would appear to be a major factor in influencing a firm to undertake direct investment abroad.

Footnotes

1. Myers, J.G., "Foreign Licensing - an Export Alternative", Business Quarterly, Fall, 1960, p.169.

2. The Royal Commission on Taxation, Queen's Printer, Ottawa. Vol.4, p.511.

3. Lee, C.H., "How to Reach the Overseas Market by Licensing ", Harvard Business Review, Jan.-Feb. 1958, p.78

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Observations on Why 18 Firms have Chosen Particular Countries

I

The task in this section of the report will be purely descriptive. The firms which have been studied have located subsidiaries or branches, for example, within the United States. It would be very simple to say that the United States is geographically close to Canada and provides a very sizeable market for subsidiaries of Canadian parent companies. However, in most cases, this would be an oversimplification of the existing facts. Initially those parent companies which have located subsidiaries in the United States will be discussed, then South America and the Caribbean, Europe, and other areas.

II

The Consumers' Gas Company has a subsidiary, St. Lawrence Gas Co., in Northern New York State. In this case it was a matter of economics. Consumers Gas had natural gas pipeline passing very close to the American border and because of this situation could transport natural gas to Northern New York State in the area of Ogdensburg cheaper than could American companies. As a result they located a subsidiary in northern New York State.

In the case of Distillers Corporation-Seagrams Limited, the United States provided a sizeable market. This is reflected in the fact that 90 percent of the company sales take place in the United States. A company, by locating within the United States, can avoid import duties on liquor as well as decrease its transportation costs, i.e., by having a distribution as well as production outlet closer to the actual market.

A similar case may be made for the Moore Corporation. Moore already controls 33 percent of the Canadian market. The Government would probably step in to prevent monopolistic control of the business forms market if Moore was to try to expand its operations within its own industry in Canada. As a result, for purposes of higher profitability, it is reasonable to assume that Moore Corporation would expand its operations into the United States. Where there is big business, business forms are required. Again to avoid tariffs and import duties on manufactured goods, i.e., business forms, it is reasonable for Moore to produce within the U.S., its major market, rather than to export forms from Canada. In conjunction, it is more economical for Moore to produce its own equipment within the U.S. Thus, Moore supplies its own manufacturing firms with capital equipment, saving them the duty as well as transportation costs if such equipment was produced in Canada. In addition, Moore acquires existing "marketing arrangements and know-how" via her acquisitions of these machine production plants such as Kidder Press, in the United States.

The C.P.R. has extensive rolling stock in the U.S. For an explanation we might quote Herbert Marshall in his book, Canadian American Industry,

> "C.P. crosses Maine as the shortest route from Montreal to a Canadian salt water port. It reaches a few miles south into Vermont to connect with American roads to New York and Boston. It has trackage rights over the Michigan Central from Detroit to Chicago. By its control of the Soo Line, Wisconsin Central & Duluth South Shore, it gains access to Chicago and Duluth for its traffic from the whole Regina-Winnipeg district, and incidentally obtains North Dakota-Minnesota traffic. In the North West the Spokane International gives the Canadian Pacific an outlet through the American North West.
>
> It may be said that except for the Ontario tracks, the American lines in Canada are appendages to the parent systems, whereas the American lines of the Canadian railroads provide several indispensable outlets for their traffic."

The Robert Morse Corporation located in Montreal, also has extensive holdings and subsidiaries in the U.S. As noted in the case studies, this company was at one time the Canadian subsidiary of an American parent company. However, that parent company was taken over by interests other than the Morse family. When this occurred, Robert Morse III moved to Canada, bought the Canadian subsidiary, and severed all ties with the parent company. He began operating it as a Canadian company and started acquiring American subsidiaries.

Besides the attraction of increased profits, one might speculate that there was a personal motive involved in this expansion of CDIV. Mr. Morse probably wants to re-establish his position as it was before the takeover of his family's company. In this regard he has acquired the Howe Richardson Scale Company in New Jersey and the Johnston Pump Co. of California.

Interprovincial Pipe Line from Alberta to Ontario crosses northern United States. The pipeline provides the shortest possible route to its terminal in Ontario as well as providing an outlet in the U.S. for Interprovincial Pipe Lines. For example, there was some talk of extending Interprovincial's American pipeline to Chicago. However, this did not pass beyond the conference stage. The Lakehead Pipe Line Co. Inc., Interprovincial's American subsidiary, operates that portion of the pipeline lying within the United States and its terminal facilities. In 1963, it began transporting North Dakota crude to refiners in Minnesota and Wisconsin.

Hiram Walker-Gooderham & Worts Ltd. owns the Hillsborough Glass Co., formed in 1961 to produce bottles for the liquor it produces at Peoria, Illinois. Similar then to the Distillers-Seagrams case, Hiram Walker wishes to have an outlet in the U.S. Therefore, they manufacture liquor within the U.S. for reasons similar to those given above. However, their ownership of the Hillsborough Glass Co. facilitates the integration of their American operation, i.e., bottles are produced.

For similar reasons Canadian Breweries own a malting company in the United States, that is, to provide Malt for their manufacture of beer within the United States.

The Fraser Company has located in the United States to gain access to its broad markets. It avoids import duties by shipping raw materials under the St. John River to its plant in Madawaska, Maine. At this plant it manufactures paper which is then sold in the northeastern American market. If it produced such goods on the Canadian side of the St. John River, import duties would have to be paid. This concludes that part of this discussion dealing with location in the United States by Canadian firms. A discussion of location in other particular countries follows.

III

We discuss now some observations on why Canadian firms located in Latin America and the Caribbean area.

The company with major holdings in the Caribbean is Alcan Aluminium Ltd. Its subsidiary, Alcan Jamaica Ltd., established in 1953 is part of Alcan's $125 million investment in Jamaica. The company is involved in mining for bauxite deposits, as well as producing alumina. In this case Alcan located in Jamaica because that country provided it with bauxite, the raw material necessary for production of aluminum. Similarly, Alcan has located in other countries in mining for bauxite. This move towards vertical integration is in keeping with the company's policy and self-perpetuation. Another side to this fact is that Alcan has established rolling mills in the United States where it markets its final product, i.e., aluminum foil or aluminum products. Demerara Bauxite Ltd. located in Mackenzie, Guiana, serves a similar purpose. Alcan also has an 85.3 percent interest in Aluminio del Uruguay based in Montevideo, Uruguay, and an 81 percent interest in Aluminio Alcan de Columbia, S.A., an extrusion plant that also produces sheet metal. Uruguay, a South American country which is developing rapidly, provides a market for sheet metal and as Alcan can provide the technical skills and the necessary capital, it has an advantage, in locating in such an area, over a firm just beginning in the industry. Alcan also has subsidiaries in Mexico, Brazil and Argentina.

Not to be overlooked is the fact that many of these countries such as Jamaica offered tax concessions, such as tax holidays, accelerated depreciation and depletion allowances, to international firms to locate in these areas.

Distillers Corporation-Seagrams Ltd. located in Mexico because no imports of run are allowed in that country. As a result they established a plant to produce rum for that market.

Salada Foods has invested substantially in British Honduras in acreage to grow citrus fruits, Its reason for locating in British Honduras was in part to diversify the risk, i.e., if its crop in Florida was destroyed by drought, or something of that nature, it would always have another crop in British Honduras, thus stabilizing its earning power. The same company produces Luscious Jello in Jamaica in order to sell it to other sterling areas. Low labour costs aid in convincing such a company to locate in Jamaica.

The Moore Corporation locates in El Salvador and other South American countries in small plants. As these economies grow, the need for business forms will also grow and Moore is seeing that it is entrenched in those domestic markets from the first. As to its investment in El Salvador, it invested in that area to gain access to the Central American common market. We proceed now with a discussion of Canadian firms which have foreign subsidiaries in Europe.

IV

Alcan Aluminium Ltd. owns Alcan Aluminio Italiano S.P.A., a producer of primary and secondary aluminum ingots. It also has subsidiaries in Germany manufacturing castings and sheet utensils. It owns a bauxite mine in Southern France. Alcan is trying to build up as much bauxite reserves as possible. In accordance with this policy it locates in Southern France as well as in Jamaica. I would speculate that its bauxite mines in Southern France ship bauxite to its manufacturing plants in Germany and Italy and its bauxite mines in Jamaica and South American ship bauxite to the American and Canadian sub and parent. In this way transportation costs are maintained at a minimum.

Distillers Corporation-Seagrams Ltd. owns Chivas Bros. Ltd. in Scotland as well as Robert Brown Ltd. and the Sir Robert Burnett & Co. Ltd. based in England. The latter is involved in the production of gin, the former in the production of Scotch. In this way, Distillers Corporation-Seagrams, which produces its own whiskies in the U.S. and Canada, gains access to production of other types of alcoholic beverages which have an established name in the market. Distillers, then, locate in these areas for the above mentioned purpose. A similar case may be made for Hiram Walker's holdings in the Scottish whisky industry. Seagrams Overseas Corporation imports and exports alcoholic beverages. It develops overseas production facilities for other subsidiaries as well as serving as a distribution outlet for its parent.

MacMillan Bloedel owns High Grade Corrugated Cases Ltd. and Cooks Corrugated Cases Ltd. in the United Kingdom. Both companies were important consumers of liner-board manufactured by MacMillan. Perhaps wishing to diversify within the wood and pulp and paper industry, MacMillan Bloedel established itself in these subsidiaries in the United Kingdom. MacMillan Bloedel also has a sales representative company in Britain to represent its interests and develop them in the United Kingdom. It purchased a 35% interest in a Netherlands paper manufacturer in 1965 for about $15 million. In this way it gained access to the European common market countries.

The Polymer Corporation has located in France, Belgium, Netherlands, Switzerland, as well as in Mexico. Polymer established joint ventures rather than wholly owned subsidiaries in Mexico and South Africa because of "the desire of many countries to have an internal synthetic rubber supply". The reason for Polymer's minority participation in these countries was that, that was all they were permitted.

The main reason for Polymer's establishment of subsidiaries in Europe was the increased competition from its competitors, particularly from the United States, in the production of synthetic rubber. Polymer, until 1961, relied primarily on exporting synthetic rubber but found itself unable to keep up with the demand for their product. The corporation considered it had to build plants other than maintain exports even if it could have met the demand because of the development of new trading blocks in Europe, specifically the common market and the Outer Seven. If Polymer was not to lose its markets it had to construct plants within the common market tariff wall.

Of particular interest are the reasons given for the establishment of Polysar International in Switzerland, Polymer's international sales and distributing organization. Polysar International diverts Polymer's sales

profits into Switzerland where the tax rate is about 18 percent. Such profits otherwise would be taxable in Canada at 52 percent. Note however this is a Canadian company owned by the Canadian government and the above move does nothing but strengthen the short run financial position of the corporation.

V

Companies such as Alcan have further extensive holdings in Oceania, Australia and India, again in the production of aluminum products as well as in the mining of bauxite. It would be redundant to explore these for location by Alcan in both developed and underdeveloped areas, in both areas where the raw material is accessible as well as in areas where there is a market for manufactured aluminum products, as discussed earlier.

Another possible reason for location in a particular country can be culled from the example of Cominco who have entered a joint venture with a Japanese company. Their company is called Mitsubishi Cominco Smelting Co. Ltd., in which cominco has a 45% interest. Construction of a 40,000 ton lead smelter at Nayoshima, Japan, was completed in 1966. Refined metal production from the treatment of lead concentrates are purchased from Pine Point Mines Ltd. which is a Cominco subsidiary in British Columbia. We might speculate that one of the reasons for Cominco's entering such a venture was to stimulate the sales of lead concentrate of its other subsidiaries to a highly developed country, that is Japan.

Alcan made some investment in bauxite mines in Nigeria on the basis that that country was politically stable, that is, risk of investment in that country was minimal. The present civil war raging in that country, reflects either Alcan's faulty research in arriving at such an investment decision, or the lack of any research. The point, however, that we are trying to bring out is investment is often undertaken on the basis that the capital-importing country is politically stable, enhancing its desireability as a foreign investment.

VI

CONCLUSIONS

A summation of some of the reasons for location in particular countries is in order.

A company may locate in the United States because of its proximity, as in the case of Consumers Gas. The availability of a large market for its product, attracts other firms such as Distillers Corporation-Seagrams Limited. The desire to achieve vertical integration within its American or overall operation is the case of Moore Corporation. Avoidance of the American tariff is often the reason for location in the United States, for example, the Fraser Company. Utilities, pipelines and railways have direct investment in the United States because it may provide the shortest route, i.e., the most economical, or to attract some American business to Canada.

Location in Latin America and the Caribbean area often takes place because of the national resources of those countries, and in some cases, the growing purchasing power of those countries. For example, Alcan Aluminum locates in Jamaica, in mining bauxite, a raw material that is the basis of its production of aluminum. This type of investment is an integral part of the firm's policy of vertical integration, as are the establishment of plants to manufacture aluminum products in Uruguay.

Similarly, Distillers Corporation-Seagrams Limited has plants throughout South America and Mexico, to produce liquor for the home market as well as to produce domestic liquor such as rum, for export to other markets such as Europe, the United States and Canada.

Moore Corporation locates so that it may dominate that domestic market when such a market develops, i.e., in South America. The importance of external tariffs against imports of manufactured goods such as business forms, has played a significant role in making the decision to invest in a country such as El Salvador.

Low labour costs and tax concessions such as accelerated depreciation attracted Salada Foods to produce Jello in Jamaica. Exchange rate difficulties are, in this way avoided, on sales within the sterling area.

An important reason for direct investment in Europe, is the existence of the European Common Market. In order to avoid its outer tariff, such companies as Polymer have located in France and Belgium. The political stability of these European countries, reduces the risk involved in such investments.

From this summary, it is implicit that the existence and size of tariffs have a strong influence on the foreign investment decision. One wonders how significant an effect the new Kennedy round tariff cuts will have on direct investment. Will these tariffs decrease sufficiently so that it will no longer be economical to continue direct investment? A question, then for future reaearchers.

Footnotes

1. Marshall, H., Canadian-American Industry, pp.187 and 188.

2. Polymer Corporation, Annual Report, 1966, p.6.

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CHAPTER 9

Comments on Changes over Time in Intra-Enterprise Relations

I

An attempt was made in the collection of information for the firm profiles to determine the extent of any changes that took place in the period under study in the intra-enterprise relationships and the relative importance of the parent company vis-a-vis its subsidiaries abroad. Unfortunately, as in the case of much of the information that was needed to complete the firm profiles, sufficient information was lacking. However, a brief description should be given of the type of information that would be needed as well as of the rationale for gathering such information.

II

Briefly, the information which might indicate a change over time can be of two types. The first type would be that which would indicate a change in the degree of supervision or, at least, involvement of the parent in the operations of the subsidiary. The second type of information would relate to the actual results of the operations of the subsidiary as they relate to the total results of the direct investment, multi-national corporation.

III

The first type of information,that relating to parental involvement, would include changes in the number of parent personnel, or parent-affiliated personnel, associated with the management or Board of the subsidiaries. In this area, changes in the contact between parent and subsidiary, both personal and through reports. Are there any changes in reporting procedures over time? Do procedures for common budgeting and uniform accounting systems change? If the parent plays an important role in the purchasing procedures of the subsidiary in its initial stages, does this change over time? Has the degree and nature of foreign ownership of stock changed over time?

IV

The second type of information, though not completely divorced from the first type, is of a different nature. It is concerned with the results of the operations of the subsidiary in context of the total operations of the international firm. Here one is concerned with changes in the product mix, changes in imports and exports, particularly as the changes reflect less dependence on the parent, changes in percentage of sales that go to national market and changes in the subsidiary's contribution to total sales, as well as profits, fixed assets, etc., of the corporation. Of interest here also, are the changes in research facilities and development, and in the source of funds for subsidiary relations.

V

The question that must be answered is why one is interested in these changes that may take place. The basic justification for gathering such information is to determine the degree to which the subsidiary becomes self-sufficient both in its operations and in its productive and marketing efforts. The degree to which the subsidiary is independent and, as a result, in a position to undertake maximum potential development, may be important in determining the degree to which direct investment is a positive or negative factor in the economy of the capitol-receiving country.

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See Appendix "G" for additional bibliography

CHAPTER 10

Comments on Decision-Making Within CDIA Firms

I

An analysis of internal decision-making within CDIA firms is basic to an understanding and evaluation of the operations of such firms in terms of the costs and benefits of direct investment both to the capital-providing country, in this case Canada, and to the capital-receiving country. Such an analysis should concentrate on how and by whom decisions are made with respect to finance, marketing, production, internal structure, external relations and other areas. The answers to these questions should provide insight not only into what decisions are made but also into why such decisions, and not others, were made. It is upon the latter two aspects that the most valid assessment of costs and benefits will be based.

It is not the intention here to provide in great detail a complete inventory of the areas to be covered or the specific items to be examined. A more complete, though by no means exhaustive, description of, as well as a rationale for, such a study is included as Appendix "G" of this report. Rather it is our intention here to cite several examples that have arisen from the case studies as they relate to the issues, and concomitant difficulties involved in this area. The examples will emphasize the two basic issues usually discussed in this area: use of parent personnel in subsidiary operations, and the policies pursued by the management of subsidiaries. It must be emphasized that most of the following comments are based on speculation, particularly those dealing with corporate policies. Wherever possible, evidence will be cited to substantiate the speculation.

II

Most of the companies studied did follow a policy of using Canadian or parent executives at some stage or level in the operations of the subsidiary. Several factors might be suggested as valid reasons for the policies followed in this respect.

Several companies stand out for the heavy reliance placed on the use of parent executives in the subsidiaries. Polymer Corporation appointed almost all of the senior executives of its foreign subsidiaries from within the executive ranks of the parent. There was also evidence of movement in the other direction, i.e. executives within the subsidiaries assuming positions within the parent. Such a policy is no dobut due to two factors: first, there is the relative recentness of the establishment of the subsidiaries; secondly, there is the complexity of the Polymer operations. Accordingly, the need for trained executives to operate the new subsidiaries can be justified. However, the point to be raised is whether this policy will change over time.

The operations of the parent, Fraser Companies Limited and its subsidiary Fraser Paper are perhaps the most highly integrated of the firms studied. The Board of Directors and the senior personnel of the subsidiary are essentially the same individuals. Here, the proximity of the two operations plus their integration probably account for the policy of personnel integration.

Moore Corporation is another interesting example of personnel integration. Not only are Canadian personnel sent to run the subsidiaries but the senior managerial positions within the parent and subsidiaries are also the same individuals. In 1954, the general manager of two of the three divisions of the business forms subsidiary as well as of one of the equipment subsidiaries were Canadians, originally at least. This example illustrates at least one of the problems of merely determining the nationality of the executives. After a time, as in the case of Moore, perhaps five to ten years, what difference does it make that a Canadian is the General Manager of an American subsidiary? The answer to this can only be empirically determined, and then only in an inferential manner.

Other companies follow what would appear to be a highly decentralized operation in the sense that executives of the parent <u>officially</u> have very little to do with the subsidiaries. One such example is Cominco. In 1964, only two of the senior personnel in the parent was listed as holding a post in one of the four subsidiaries. Of course, the senior personnel of the subsidiaries may have had earlier affiliations with the parent.

Interesting examples of parent-subsidiary relationships are those of Salada Foods and Crush International. In both cases, the President of the American subsidiary became President of the Canadian parent. In the case of Salada, the person in question appears to have been sent down to the subsidiary for training. However, there is no such indication that that is the case in Crush's situation; indeed, the new President may have been an American.

III

There are very few examples of the influence of parent on subsidiary policies. One of the few concerns, Canadian Breweries, is highly suggestive of the potential influence of the parent. In 1965, as the case profile outlines, one of the plants of the American subsidiary was closed down after only two months of operation. The officers of the parent were highly critical of the management of the American subsidiary. Although the executives of the parent stated that because of American law they could only "collaborate" with the subsidiary and not issue orders to it, Nevertheless, two Canadians were sent down to "strengthen" the subsidiary. Subsequently, two of the plants were sold. Officially, sale was on the recommendation of executives of the subsidiary.

Another example, again relating to Canadian Breweries, suggests the influence of parent on subsidiary operations. In 1962, subsequent to the purchase of the Beamish and Crawford Brewery, an extensive expansion was undertaken. Although management of the subsidiary remained intact, the new International Division of the parent was responsible for planning and executing the whole expansion program.

IV

Thus far examples of personnel and policy integration of parent and subsidiary operations have been cited as they relate to the age of the subsidiary, the complexity of its operations and problems it encounters. Integration may also result from the development of production integration. Such may be the case with Moore which is a vertically integrated firm in that the business forms subsidiaries rely on the machinery subsidiaries for their equipment. A similar example could be Polymer where the French subsidiary which produces specialty rubber may be highly dependent upon the butyl plant in Belgium. Accordingly, the firm may require highly centralized operations to ensure satisfactory operations.

V

Examples might also be given to illustrate the deficiencies of the definitions of direct investment with their supposed concomitant result of "control". Moore Corporation has three associated companies in which Moore has a 49%, a 45%, and 20% interest. Yet her influence over the operations of these companies may be far greater than her interest, or investment, would suggest. This influence would result not so much from the degree of ownership held by Moore but from experience in the field and control of specialized machinery produced by wholly owned subsidiaries and not sold to others. A similar case can be made for Cominco which has minority interests in two firms in India and Japan but may have majority influence because of her experience and developed state of her technology.

VI

Little information is available from the case studies to permit valid comparisons between Canadian owned direct investment firms and foreign owned Canadian direct investment firms. Do they operate any differently? If so, in what way? Are the differences the function of differences in the nationality of ownership? Unfortunately, no information is available.

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See Appendix "G" for additional bibliography

CHAPTER 11

Comments on the Corporate Citizenship of Firms within Host Countries

I

The issue of corporate citizenship is one that is introduced into every discussion of the economic costs and benefits of direct investment. In most discussions, however, the term is used very ambiguously and means different things to different people. It is the intention here to define corporate citizenship and then relate, where possible, the definition proposed to examples drawn from the firm profiles.

II

There are several levels of corporate citizenship. The most elementary level is analogous to that of the individual citizen. This level has two aspects to it. The first is the passive aspect in that the citizen accepts the laws of the state in which he resides. At what could be called the more active level of this type of citizenship, is the participation of the citizen in community affairs and contributions he makes to charitable and educational institutions. Generally, one could call this type of activity the overt manifestations of "civic consciousness". There are several examples of this elementary type of citizenship at the corporate level. Alcan's subsidiary in Jamaica accepted the laws of Jamaica which require that any land being mined must be developed agriculturally by the owner of that property. Accordingly, in Jamaica, Alcan has diversified into agricultural development and cattle ranching. Another example is that of Consumer's Gas which agreed that its subsidiary would not increase retail prices in the United States following the fixing of higher rates by Canadian authorities.

An example of a corporate citizen that was accused of not following the laws involves Canadian Breweries. It was suggested in 1956 that Canadian Breweries, through its subsidiary, Carling Brewing Co. in the U.S., was attempting to monopolize the market and engaging in illegal price cutting. At one point bills were introduced in four United States' legislatures that would have prevented the subsidiary from selling beer in the States concerned. An example of a similar nature involves Alcan Aluminum which withdrew an application to purchase a smelting company in the United States after objections were raised by the Department of Justice.

Moore Corporation has apparently followed a policy of encouraging its personnel in the United States to participate in community activities. From the little information available, it appears that this policy was appreciated by the communities in which Moore subsidiaries were located.

Little information is available, however, that might indicate the degree to which foreign subsidiaries did follow an active policy of citizenship as defined above. Judging from the limited amount of legislation that was prompted by subsidiary activity, it would appear that most subsidiaries were passive citizens at least.

III

It is questionnable whether such criteria such as local legislation, court actions, community participation and corporate, charitable giving are valid (or at least sufficient) criteria for evaluating the corporate citizenship. On the one hand, these may reflect mere acceptance of the laws (which one would expect as normal), and on the other hand, they may reflect a concern with public relations. Thus it is necessary to examine the definition and manifestations of corporate citizenship more closely.

IV

The essence of corporate citizenship is to be found primarily not in the degree of participation of a subsidiary's officers in community activities or in the amount of corporate giving to charity and education,

but in the kinds of decisions a company's board and management make with respect to productions, planning, financial policies and so on as they affect the economy of the host country. Good corporate citizenship requires that in making decisions in these areas, the company will be aware of, and accommodate itself to, national objectives.

Thus, to be a good corporate citizen, a direct investment firm should make decisions that relate to the "establishment of a community of interest" between the foreign countries and the Canadian firms resident therein. Unfortunately, however, for the purposes of this study, no information was available upon which to judge whether or not Canadian firms abroad are good or bad corporate citizens.

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See Appendix "G" for additional bibliography

CHAPTER 12: PART A

Speculation about the Interdependency of Canadian Federal Government Policies Regarding CDIA and U.S. Federal Government Policies Regarding the U.S. Balance of Payments

I

How might the U.S. Federal Government react if the Canadian Federal Government decided to pursue an active and selective policy of encouraging a greater proportion of new private investment to flow from Canada to countries other than the U.S.?* What would be the likelihood of the U.S. Government eliminating the favourable preferential treatment that Canada currently receives with respect to the Federal Reserve Board's guidelines to U.S. financial institutions under the Voluntary Program to Improve the U.S. Balance of Payments? What would be the likelihood of the U.S. Government applying (via the Department of Commerce) additional moral suasion on U.S. firms with direct investments in Canada (and particularly, perhaps, on those which have direct investments abroad from their Canadian located subsidiaries) under the Voluntary Program to Improve the U.S. Balance of Payments? What would be the likelihood of the U.S. Government reducing or eliminating the exemption that Canada currently receives from the U.S. Interest Equalization Tax?

II

To a degree, speculation on such questions depends upon whether it is assumed that the deficit in the U.S. Balance of Payments will be a long run deficit or a short run deficit. If it is assumed that it will be of a short run one-year duration (a rapid reduction of U.S. dollar out flows for the "substantial costs of Vietnam," and/or the success of the Voluntary Program, etc.) then speculation on the questions raised above is probably of less significance than if it is assumed that the U.S. deficit is of a chronic nature. The reason for this conclusion is that at the present time the Canadian Federal Government does not have an explicit policy relating to CDIA let alone a selective policy of encouraging CDIA to flow to countries other than the U.S. Consequently, a time-lag of at least a year would likely be required before any such policy became explicit and, if the deficit on the U.S. Balance of Payments was considered no longer to be a problem by the U.S. Government at the time any such Canadian policy became explicit, the question of conflict between national policies would no longer be a highly significant question. The discussion below assumes that the deficit in the U.S. Balance of Payments is a chronic deficit (at least 3 to 4 years) and that the Canadian Government develops an explicit selective policy with respect to encouraging CDIA to flow more heavily than at present to countries other than the U.S.within the next two years.

III

The U.S. Government's Voluntary Program with the relevant U.S. private business interests was launched in early 1965 in an attempt to overcome "the persistent deficit" in the U.S. international accounts. The program involves "neither specific legislative authority, compulsory participation, nor mandatory standards of performance".(1) The U.S. Government defined a specific national objective and exerts moral suasion on the relevant private business corporations and financial institutions to be "patriotic" by working towards achieving the defined national objective. The aspects of the program relating to financial institutions are administered by the Board of Governors of the Federal Reserve System. The aspects of

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* The policy of discouraging private investment from flowing from Canada to the R.O.W. is touched on only briefly as is the selective policy of encouraging new investment to flow more heavily to the U.S. than at present.

the program relating to business corporations are administered by the Department of Commerce.

Under the Department of Commerce program, executives of business corporations with affiliated enterprises abroad were urged: "to moderate the outflow of funds from the United States for direct investment (a 25 per cent equity definition) in the developed countries"; to repatriate "income from abroad"; to repatriate "short-term foreign financial assets"; to make "the maximum possible use of funds obtained abroad for investment purposes"; and, of course, to maximize "export expansion". With regard to "the less developed countries, the voluntary program seeks to avoid adverse effects on these areas" since it is the national objective of the U.S. Government "to encourage American private enterprise to assist in the introduction of modern techniques and to help raise standards of living in these countries".(2) A number of economically under-developed countries are considered "developed" because they are "within the Sino-Soviet bloc": Cuba, Tibet, any part of Viet Nam that is dominated or controlled by international communism, etc.(3)

In 1965, Canada was not included within the scope of the direct investment target. In 1965, the capital transactions between U.S. parent companies and their Canadian affiliates increased substantially which more than offset the improvement on U.S. direct investment transactions with other developed countries. Consequently,* in 1966 the U.S. Government found it necessary to include Canada within the scope of the direct investment target for 1966. This policy was continued in 1967.(4)

Under the Board of Governors of the Federal Reserve Board, U.S. banks were given guidelines to moderate their outflow from the U.S. of funds for non-export credits to developed countries and non-bank financial institutions were given guidelines to limit their aggregate holdings of "covered" foreign financial assets. The banks were asked to give special favourable consideration to certain countries, including Canada, which traditionally had raised large sums in the U.S. capital market.(5) Of even greater importance to Canada is the special favourable treatment given with respect to non-bank financial institutions which are the principal purchasers of Canadian securities sold in the U.S. The Federal Reserve guidelines for non-bank financial institutions while asking that they reduce their holdings of liquid funds abroad including those held in Canada, gave Canada favourable treatment for credits and investments exceeding ten years in maturity and did not impose any limit on security investments. Of great importance in this latter category has been Canada's exemption from the U.S. Interest Equalization Tax (I.E.T.) of 15 per cent for new issues of Canadian securities.(6)

IV

Canada is exempt from the U.S. I.E.T. levied on purchases on foreign securities from non-American citizens by residents of the U.S.** The main reason for Canada's exemption is that Canada is considered to be a net contributor to the U.S. Balance of Payments. The quid pro quo was the commitment Canada made not to use its exemption to build up foreign exchange reserves at U.S. expense.(7) The understanding reached between Canada and the U.S. is that if and when Canada's foreign exchange reserves go above $2.55 billion (U.S.), the Canadian Government would reduce its reserves (by purchasing, for example, Canadian bonds held in the U.S.).(8)

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* It should be noted that the U.S. Government recognizes "that we have a large and currently growing export surplus with Canada". Andrew Brimmer, U.S. Assistant Secretary of Commerce for Economic Affairs.(9)

** There is apparently a leakage flow: U.S. citizens in Canada signing ownership affidavits on behalf of residents of the U.S. seeking to evade the tax as it applies to other countries.(10)

V

It is conceivable that the Canadian Federal Government might decide to pursue an active and selective policy of encouraging a greater proportion of new private investment to flow from Canada to countries other than the U.S. (The concern here is with CDIA only.) There are a number of possibilities:

1. A policy designed simply to increase the relative accumulation of CDIA in non-U.S. countries (perhaps based on an economic diversification argument or on a purely political argument).

2. A policy designed to increase the relative accumulation of CDIA in Western Europe particularly, for example, France (perhaps to foster greater economic and non-economic linkages).

3. A policy designed to increase the relative accumulation of CDIA in the Carribean (perhaps to strengthen Canada's influence in this area).

4. A policy designed to increase the relative accumulation of CDIA in the Commonwealth countries, both in the economically developed countries (Australia) and in the so-called economically underdeveloped countries (Ceylon).

5. A policy designed to increase the relative accumulation of CDIA in the economically underdeveloped countries of the World including, perhaps, Cuba.

If there were active Canadian Federal Government intervention via for example, special selective CDIA guarantees to encourage CDIA to flow to, and accumulate in, specific countries or groups of countries other than the U.S., Canada would be open to three related charges by the U.S. Federal Government.

First, other things being equal, Canada by encouraging a relative shift of CDIA away from the U.S. would become less of a net contribution to the U.S. Balance of Payments in both the short run and in the long run (dividend payments on CDIA from the U.S. would, however, tend to be less than they otherwise would). This charge would take on a particular significance since there has been, for the 1954-1964 period, a relative geographical shift of CDIA away fromthe U.S. to the R.O.W.: the U.S. share of CDIA assets being 60 per cent in 1964 compared to 76 per cent a decade earlier.[11] This shift has taken place without an explicit consistent Canadian Federal Government policy on CDIA.

Secondly, Canada by encouraging a relative shift of CDIA away from the U.S. would become a more attractive and apparent "leakage" point for U.S. savings and investments. This second argument would take on a particular significance since non-residents of Canada, including residents of the U.S. have substantially increased their relative equity share of CDIA assets: the non-resident share being 39 per cent in 1964 compared to 30 per cent a decade earlier.[12]

Thirdly, and relatedly, Canada by encouraging a relative shift of CDIA away from the U.S. would, at the aggregate savings level (albeit one step removed), simply be using U.S. savings to finance Canadian direct investment in countries other than the U.S. This argument could be put in a specific context: Canada, by creating special incentives for CDIA to flow to countries other than the U.S., would beusing a backdoor alternative technique of reducing potentially excessive Canadian foreign exchange reserves. And this would be breaking the spirit of the quid pro quo understanding reached about Canada's exemption from the I.E.T. and aspects of the U.S. Voluntary Program for financial institutions.

VI

The U.S. Voluntary Program to Improve the U.S. Balance of Payments is aimed at developed countries and those economically underdeveloped countries defined as "developed" because they are "dominated or controlled by International Communism". Countries such as Australia, New Zealand, the Bahamas and Bermuda are also considered to be economically developed.(13) Canada is among those countries which receive special favourable treatment under this program. It seems doubtful that the Canadian Federal Government, if it so desired, could actively encourage by specific and selective policy measures CDIA to accumulated in those countries to which the U.S. Voluntary Program applies without considering the possibility of retaliation by the U.S. Government.*

If the Canadian Government, as a matter of policy, decided to encourage the accumulation of CDIA in the economically underdeveloped countries of the world, the likelihood of U.S. Government retaliation could be expected to be somewhat less since the U.S. Government seeks to avoid any adverse effects of its Voluntary Program on these countries (excluding Cuba, etc.).(14) But the logic of this line of reasoning may have a serious flaw: the U.S. Government, by exempting certain underdeveloped countries from its Voluntary Program, receives the political credit; it would not receive the political credit for a Canadian initiative in increasing the accumulating of CDIA in the underdeveloped countries.

Finally, if Canada and Cuba reached an agreement to incourage the flow of CDIA to Cuba, the U.S. Government might be expected to retaliate on economic and/or political grounds.

VII

The above speculative comments concerning possible potential constraints on unprobable aspects of Canada foreign and/or commercial policy of the current U.S. concern for its defined "chronic deficit in its international transactions", must be taken as speculation based on such assumptions as those noted earlier. The attempt to relate CDIA to present U.S. policy with respect to the U.S. balance of payments was done in order to suggest their inter-related implications. There are definitely logical implications. The extent of the economic implications (U.S. and Canada's balance of payments, for example) would have to be explored in much greater depth than is done in this report as would the political implications.

VIII

It might be noted that one political argument in Canada for Canada not encouraging a greater accumulation of CDIA is that the present degree of control of certain sectors of the Canadian economy by non-resident private investors via their direct investments could be reduced to some extent without economic cost to Canada by simultaneously discouraging the further accumulation of CDIA (CDIA assets are 21 percent of FDIC assets).(15)

IX

The question of the reaction of the U.S. Government to a specific Canadian Government policy encouraging CDIA to accumulate in the U.S. is not explored. The expection might be that the U.S. would welcome such a policy as contributing, in the short run at least, to the solution of its current balance of payments difficulties.

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* It might be noted that the removal of Canada's exemption under the U.S. I.E.T. would have an important effect on the ability of the provinces and municipalities to raise funds in the U.S. at a reasonable rate. This could affect Canadian Federal Government policy with respect to CDIA.

Footnotes

1. Statement of The Honorable Henry H. Fowler, Secretary of the Treasury on the Balance of Payments Program for 1967, Treasury Department, Washington, D.C. (U.S.), December 13, 1966, p.2.

2. Text of Secretary Connor's Letter to 400 Chief Executives of Companies Not Previously Reporting Under the Voluntary Program to Improve the U.S. Balance of Payments, Department of Commerce, Washington, D.C. (U.S.), January 14, 1966, pp. 2 and 3.

3. Statement by Secretary of Commerce John T. Connor on Balance of Payments, Department of Commerce, Washington, D.C.(U.S.), January 17, 1966, p.8. The definition applies also to that part of the Voluntary Program administered by The Board of Governors of the Federal Reserve System. (See the Board's "Guidelines for Banks", an attachment to Press Release, dated December 12, 1966, p.2.)

4. Text: Andrew Brimmer's Remarks Before Toronto Bond Traders Association, United States Information Service, United States Embassy, Ottawa, March 3, 1966, pp. 7 and 9. Dr. Brimmer is the Assistant Secretary of Commerce for Economic Affairs, Department of Commerce, Washington, D.C.

5. "Guidelines for Banks", an attachment to Press Release, The Board of Governors of the Federal Reserve System, Washington, D.C. (U.S.), dated December 12, 1966, especially p.6. Japan and the United Kingdom were also given special favourable consideration along with "less developed countries".

6. "Guidelines for Nonbank Financial Institutions", an attachment to Press Release, The Board of Governors of the Federal Reserve System, Washington, D.C. (U.S.), dated December 12, 1966, pp. 1 - 4. Also see Text: Andrew Brimmer's Remarks....., op.cit., pp. 6 - 7.

7. Text: Andrew Brimmer's Remarks...., op.cit., p.6.

8. "U.S. Tax: It Could Apply Here; Ottawa Waits, With Fingers Crossed," in Financial Times of Canada, Vol. 56, No. 7, June 10, 1967, Montreal, p.4.

9. Text: Andrew Brimmer's Remarks...., op.cit., p.4.

10. "U.S. Tax: It Could Apply Here;...., op.cit.

11. "Changes in the Relative Geographical Distribution of CDIA (Assets), particularly 1954-1964", Part 6, Chapter 5, of this Report.

12. "Non-Resident Equity and Control of CDIA, particularly 1954-1964", Part 17, Chapter 5, of this Report.

13. Statement by Secretary of Commerce John T. Connor..., op.cit., p.8.

14. Ibid

15. "Foreign Investment", Robert W. Thompson, in The Canadian Forum, Vol. XLVII, No. 556, May 1967, Toronto, p.38. ("...to the extent that more Canadian capital was invested at home, the need for foreign capital would be reduced.")

CHAPTER 12: PART B

Canada's Foreign Aid Program and CDIA

I

There are several questions that can be asked about the relationship between CDIA and attempts by the Federal Government to assist the economic growth of the underdeveloped countries.

1. To what extent has CDIA flowed to, and accumulated in, underdeveloped countries and what "trends", if any, are evident, particularly since 1954?

2. Does present Canadian Government policy with respect to assisting the economic growth of the underdeveloped countries incorporate CDIA as one of its instruments? If CDIA is such an instrument, what does the Canadian Government do to encourage the flow of such private investment to underdeveloped countries and how successful have such attempts been? If Canada's present policies with respect to underdeveloped countries do not attempt to influence the flow of CDIA to underdeveloped countries, should the Federal Government attempt to influence (encourage/discourage) CDIA in the future?

3. What Government policies and techniques might encourage/discourage the flow of CDIA to underdeveloped countries?

4. What might be some of the possible economic and political benefits and costs to Canada of greater Government incentives to encourage the flow of CDIA to underdeveloped countries? For instance, is there a general net economic cost or a general net economic benefit to Canada from an increased annual increment of CDIA in the underdeveloped countries? More specifically, how might the U.S. Federal Government react to an explicit policy of such incentives? Conversely, what might be some of the costs and benefits to Canada of pursuing a "neutral" policy, or a "negative" policy?

These few questions are discussed in the above order, below.

II

The given geographical distribution classification of CDIA by DBS imposes limits on an analysis of CDIA in underdeveloped countries. A specific country-by-country classification of CDIA, or a group classification of "underdeveloped countries" and "all other countries" (on the basis of a U.N. classification), is required before proper analysis can be applied to this aspect of CDIA aggregate statistics. It should also be remembered that the Canadian dollar value of CDIA assets in any given year is the total value of CDIA at the end of that year and consequently the figure includes not only the flow of direct investment from Canada and investment from retained earnings abroad but also any revaluation of the book value of CDIA assets that may have been made, changes in the external value of the Canadian dollar in terms of the currencies of all countries, etc. It is not possible, therefore, from the DBS statistics to determine what proportion of the annual increment in CDIA is the result of real capital accumulation. However, some speculation is possible on the basis of the available DBS statistics and classifications.

If it is assumed that the countries grouped geographically as South America, Other America, Asia and Africa are representative of underdeveloped countries, then the following general results are obtained. Between 1954 and 1964, the relative proportion of CDIA assets in the more economically developed countries (U.S., U.K.) and groups of economically developed countries (Europe, Australasia) declined from 88 per cent of the total to 84 per cent of the total. There was also a slight decline in the relative share of Africa, particularly in the non-South Africa area of Africa. The increase in the relative share of the R.O.W. (mainly the underdeveloped countries) took place in Other America almost entirely. This last point should be emphasized: Asia, Africa and Latin America <u>combined</u> did not increase their aggregate relative

share between 1949 and 1964 (8.4 per cent in 1949 and 8.5 per cent in 1964) whereas the relative share of Other America did increase (2.7 per cent in 1949 and 7.6 per cent in 1964). Other America includes sterling area countries and French and Dutch possessions in the North, Central and South America hemispheres. Further case-study research may indicate that the expansion of two or three CDIA firms in Other America accounted for most of the absolute increase in CDIA assets in that area (and consequently the relative upward shift for the area). For example, the number of employees of Alcan in the Caribbean increased from 6,683 in 1954 to 8,464 in 1964 and for South America (which overlaps with Latin America and Other America) the number of employees increased from 2,315 in 1954 to 5,798 in 1964. Massey-Ferguson also expanded their CDIA assets in Other America. The expansion of Salada Foods Ltd. via the British Honduras Fruit Company and Shirriff's (Jamaica) Ltd. was also important. Real estate interests may also be significant. Further research along these lines is clearly required. It is worth noting, perhaps, that there is a very small absolute amount of CDIA in Asia and Africa where the great bulk of the people of the underdeveloped areas of the world live (excluding Mainland China).

Relative Geographical Distribution of CDIA (Assets), percentage relative shares

	Total	U.S., U.K., Europe, Australasia	Latin America	Other America	Africa	Asia
1949	100.1	89.0	5.1	2.7	2.2	1.1
1954	100.1	88.0	4.8	3.4	3.0	.9
1964	100.0	83.9	5.0	7.6	1.9	1.6

In terms of growth rates for the 1954-1964 period, the developed country category and Africa had a 98 per cent increase and a 35 per cent increase respectively compared to a total growth rate of CDIA of 107 per cent. Latin America's growth rate was only slightly greater than the total CDIA growth rate and Other America and Asia were substantially greater than the total growth rate. (It should be emphasized that for the 1949-1964 period the growth rates for Asia, Africa and Other America would be calculated from very low absolute dollar-values in the base years: $10 million, $20 million and $25 million respectively in 1949). It should also be remembered that the change in the dollar-value figures are net figures: there has, for example, been disinvestment in India by Ford and Sun Life. It is likely that the net dollar-value increase in Asia is the result of the expansion of Alcan in India.

Relative Geographical Distribution of CDIA (Assets), $ million and Growth Rates

	Total		U.S., U.K. Europe Australasia		Latin America		Other America		Africa		Asia	
	$	1954 100	$	1954 100	$	1954 100	$	1954 100	$	1954 100	$	1954 100
1949	926	57.2	824	57.9	47	61.0	25	45.5	20	41.7	10	66.7
1954	1,619	100.0	1,424	100.0	77	100.0	55	100.0	48	100.0	15	100.0
1964	3,356	207.3	2,814	197.6	167	216.9	255	463.6	65	135.4	55	366.7

The general conclusion can be made that CDIA made a great absolute dollar-value contribution in 1964 to the underdeveloped countries as a group than in 1954 (and 1949) and that, relatively speaking, the underdeveloped countries as a group were more favourably "treated" (in terms of the allocation of CDIA) in 1964 than were the developed countries compared to 1954 (and 1949). It cannot, however, be concluded from the above data that, for example, as a proportion of total domestic investment of the underdeveloped countries the annual increment in CDIA made a greater contribution to their capital formation in 1964 than in 1954. Nor can it be concluded that in real per (Canadian) capita terms, there has been an increase. The use of additional data would be required to suggest answers to these kinds of questions. Additional data would also be required to note whether or not the annual increment of CDIA in underdeveloped countries has changed since World War II as a percentage of the dollar value of Canadian Government financed forms of aid and private capital flows. While this additional data is available, time does not permit more than a raising of the questions in this Report.

At the present time, the Canadian Government does not appear to have an explicit or specific policy of encouraging or discouraging CDIA to flow to, and accumulate in, underdeveloped countries. As is discussed below, certain Federal Government policies (designed to achieve other objectives) have an incidental side effect on the flow of CDIA to underdeveloped countries: some having an incentive side effect and others having a disincentive side effect. Even though the net effect may be to encourage CDIA to flow to the underdeveloped countries (only two examples are given), it does not appear that this is the result of an explicit policy designed to have this effect. It is reasonable to say that the Federal Government does not have a policy; it is at best a "non-policy".

There are a few inadequate indications that actual specific Government policies in the past have tended to create disincentives to the flow of CDIA to underdeveloped countries (judged in terms of particular comparisons). It is impossible to quantify what the accumulation of CDIA in the underdeveloped countries would have been if such Government policies had been different. For example, up to less than a year ago Canada's Trade Commissioners (Department of Trade and Commerce) were instructed to pursue a so-called "neutral" policy with regard to Canadian residents (firms and individuals) engaged in or contemplating direct investment abroad; the Trade Commissioners were instructed neither to promote, facilitate or encourage CDIA nor to put any barriers in the way of Canadian residents involved in CDIA. The primary function of the Trade Commissioners was to favour exports from Canada over CDIA, that is, CDIA was less competitive with its partial substitute, exports, in the short-run than it would have been if the Trade Commissioners had given equal attention to actual and potential CDIA compared to the attention given to exports.

On the other hand, certain provisions of the Canadian Income Tax Act appear to have had an incentive effect on the flow of CDIA from Canada to the underdeveloped countries. (Whether or not the relevant provisions in the Income Tax Act were designed to create such incentives is difficult to judge.) The Income Tax Act, in section 28(1)(d), states that dividends derived from direct investment in a foreign corporation -- at present where more than 25 per cent of the voting shares are owned -- are exempt from Canadian corporate income tax on receipt in Canada. The only condition for this exemption is the required degree of ownership.[1] Since underdeveloped countries as a group may tend to have lower withholding taxes on dividends of foreign subsidiaries located in their countries and lower corporation tax on profits ("tax holidays") than the developed countries as a group, the effect of the Canadian tax provision with respect to dividend earnings from CDIA (25 per cent ownership definition) increases the relative attractiveness of Canadian direct investment in under-developed countries compared to developed countries. The Royal Commission on Taxation notes that there is evidence "that the provision has offered the possibility to use Canada itself as a tax haven for international business. Data...show that...a very substantial part of the dividends reported under this section has originated in jurisdictions imposing little or no tax, and that a very high proportion of these dividends has been received in Canada by holding companies not having a substantial Canadian economic interest but representing for the most part foreign ownership".[2] As noted in the section on the aggregate statistics, the geographical distribution of dividend receipts on CDIA has shifted away from the U.S. to the R.O.W.: For the period 1946-1953 dividend receipts on CDIA (DBS definition) from the U.S. accounted for approximately 50 per cent of the total whereas for the period 1960-1965 they accounted for approximately 40 per cent of the total. It should be noted here that the geographical distribution of CDIA assets under the DBS definition need not necessarily be the same as the geographical distribution of CDIA assets under the Tax Division's definition: there is evidence to suggest that geographical distribution of the external assets of firms located in Canada which have between 25 per cent and 50 per cent ownership of foreign companies is heavily concentrated outside of the U.S.

It may be that there are two underlying implicit assumptions (particularly in the minds of Government policy-formulators) concerning the possible role of CDIA in Canada's economic assistance to underdeveloped countries. These two assumptions may pose a dilemma for Government decision-making on a greater role for CDIA. First, there is the assumption that private direct investment from Canada in the underdeveloped countries does contribute to

public statement it might be concluded* that the U.S. Government would not exert additional moral suasion on U.S. companies with subsidiaries in Canada which have CDIA not to take advantage of special Canadian Government incentives to encourage CDIA to underdeveloped countries (with the exception of any underdeveloped country "which is dominated or controlled by"International Communism", such as Cuba). Or, more economically harmful to Canada, withdraw Canada's current relatively favourable treatment under programs such as the U.S. Voluntary Program to Improve the U.S. balance of payments and the Interest Equalization Tax. Such a policy by Canada might not, therefore, result in an economic cost to Canada brought about by U.S. Government retaliation. If the U.S Government did retaliate, Canada would certainly have the "moral initiative" in the dispute both internationally and domestically. For the U.S., it would be the wrong issue to choose.

While there are many political aspects relating to the question of CDIA and Canada's foreign aid flows and private capital flows, the following two arguments may be of special interest.

In its calculations of the amount of official aid flows and private capital flows made by a country, the United Nations includes private direct investment. Assuming that Canada has a policy objective of contribution 2 per cent of G.N.P. to the underdeveloped countries in 1970, many methods could be used to reach this objective. Part of the increase could come from private capital flows, including direct investment. The greater the degree of reliance on private capital flows the less is the burden on Government revenue resources. In terms of domestic politics, a relatively greater thrust in foreign aid via CDIA as opposed to Government aid finance via domestic taxation, might be more palatable politically given the current assumption among some Canadian business men and politicians that the percentage share of Government tax revenue to G.N.P. is high enough. Assuming a $60 billion Canadian G.N.P. in 1970, a 2 per cent level of Government foreign aid and private capital flow (including purchases of World Bank bonds) would amount to $1.20 billion. A possible division between annual increments of Government foreign aid and private capital could be 80 per cent and 20 per cent respectively in the early 1970's. This would mean an increment of $240 million of private capital in 1970. Assuming a 50-50 split between direct investment and portfolio investment, an <u>increment</u> in CDIA of $120 million would be called for. In 1964, total CDIA <u>assets</u> in Asia, Africa, Latin America and Other America totalled only $542 million. The <u>increment</u> between 1963 and 1964 was only $36 million. A goal of $120 million for 1970 would certainly be a challenging goal for Canada's business leaders.

The second political argument is an argument against Canadian Government policy encouraging private investment, including CDIA, to the underdeveloped countries. The argument is that the present degree of control of certain sectors of the Canadian economy by non-resident private investors via their direct investments could be reduced without economic cost to Canada by simultaneously "bringing home" CDIA (which is 21 per cent of foreign direct investment in Canada in terms of assets). This somewhat mechanistic argument glosses over many problems, particularly that of the degree of non-resident indirect ownership of CDIA. While it is also an argument that primarily pertains to developed countries rather than underdeveloped countries (since CDIA is heavily concentrated in the former), the impact of policies based on the acceptance of the argument would nevertheless have an adverse effect on the economies of the underdeveloped countries. To the extent that those who favour this argument also favour assisting underdeveloped countries, selective measures limiting the impact of such policies on underdeveloped countries (the solution adopted by the U.S. in

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* The logic of this line of reasoning may have a serious flaw: the U.S. Government, by exempting non-"Sino-Soviet bloc" underdeveloped countries from the adverse effects of its Voluntary Program, receives the international political credit; it would not receive such credit for a Canadian initiative in increasing the accumulation of CDIA in such underdeveloped countries (See Part A of this chapter).

their short-run and long-run economic growth.* Secondly, there is the assumption or belief that Canadian (resident) private saving/investment is needed in Canada and its outflow should not be specifically encouraged (neither to underdeveloped nor to developed countries). This latter assumption may be contained in The Report of the Royal Commission on Taxation; whether or not it is also implicitly prevalent in official Government thinking is most difficult to say and if it is prevalent, the assumption may be undergoing serious critical examination.

These two assumptions need not necessarily be in conflict, for it can be argued that the economic benefits of CDIA (in underdeveloped countries) to Canada in the long-run more than outweigh the economic costs to Canada in the shorter-run and the long-run and that there is a net economic advantage to the underdeveloped countries, via, for example, external economies ("demonstration effects"). This general question is most complex and requires a great deal more study. Related to the economic costs are the political costs and benefits some of which have been mentioned in Part A of this chapter. Other aspects are touched on below (in sub-section V).

Canadian Government policy in this area may be in a state of transition. For example, within the last year, Canada's Trade Commissioners were instructed by the Department of Trade and Commerce to assist Canadian businessmen either actually engaged in CDIA or simply inquiring about possibilities for CDIA. The Commissioners now attempt to look at existing CDIA and potential CDIA in its full long-run context. One argument now receiving currency is that if a Canadian firm does not establish CDIA facilities abroad (even resulting in total or partial replacement of existing Canadian exports in the short-run) that some other firm from some other country might very well do so with the result of a loss of Canadian exports. It could be that such cases are more likely to occur in the underdeveloped countries than in the developed countries; such a hypothesis would have to be carefully tested. It may also be the case that the Canadian Government is pressing internationally for greater private capital flows (including direct investment) from the developed countries to the underdeveloped countries and ways of encouraging, on a multi-lateral basis, a greater flow. What may be of significance here is not the quantitative impact these possible specific changes of policy will have on CDIA but that the change represents a fundamental change in thinking concerning the relationship between CDIA and Canadian Government policy: it may mark an opening of the door for CDIA to play an explicit role in Canada's foreign aid program. Whether or not Government policy should encourage CDIA to flow to, and accumulate in, underdeveloped countries is touched on below (in sub-section V).

IV

There are a number of Government policies and techniques which could be used to encourage a greater flow of CDIA to the underdeveloped countries. Revisions of Canada's tax agreements with specific underdeveloped countries could strengthen their corporation tax-holiday incentives; Canadian Government investment guarantees to firms interested in CDIA would reduce private uncertainty-bearing. The Government could publish booklets on CDIA opportunities in specific underdeveloped countries to improve knowledge. (In the 1950's the U.S. Bureau of Foreign Commerce put out a number of publications on countries such as Pakistan, Nigeria, Central America, Cuba which give "basic information for United States' business men".) Another specific strategy could be for Canada to treat certain underdeveloped countries as equivalent to Canada for purposes of private investment, for example, an investment in Trinidad would be considered to be an investment in Canada (a branch of Canada Industrial Development Bank might be established in Trinidad). Special incentives to branches of Canadian Chartered Banks operating abroad to assist Canadian business men interested in CDIA could also be created: this linkage between a foreign country's private banks abroad and the same country's business firms interested in direct investment may sometimes be a necessary condition for new direct investment taking place. Aspects of Canada's external aid program could be geared into creating opportunities, incentives and external economies for possible private flows of direct investment in particular small countries. Canada could also play a greater leadership role in promoting international techniques to encourage the flow of direct investment from the rich nations (including Canada) to the poor nations. This last multi-lateral possibility might possibly be in conflict with other strategies of a bi-lateral nature. For each specific

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* By no means is this assumption regarding direct investment (as opposed to portfolio investment) accepted by all policy-makers or economists in either the underdeveloped countries or the developed countries.

policy measure it would be important to consider not only its administrative practicality but also the alternatives to it for achieving the given goal with a view to determining the maximum economic benefits and alternative costs to Canada (and the underdeveloped countries concerned) associated with the various alternatives. It is not the purpose of this report to examine this question in detail.

As noted in the section on CDIA and the Report of the Royal Commission on Taxation, some of the proposals of the Royal Commission could adversely affect the flow of CDIA, including the flow to underdeveloped countries, unless "tax-sparing" treaties were signed with these countries.

V

Very little can be said in a quantitative way about the long-run economic costs and benefits to Canada of actively encouraging (via specific policies) CDIA to flow to the underdeveloped countries. Besides the general consideration of the implications of the levelling off of the flow of aid and investment from the rich countries to the poor countries since 1960, the relative short-run and long-run economic advantages and disadvantages (opportunity costs) to Canada of the increase in foreign aid flows and private capital flows in the form of CDIA compared to loans, grants, tied exports, imports, etc., would have to be considered. The argument that certain types of private direct investment from a rich country in a poor country results in short-run and long-run export-creation from the rich country involved seems to be gaining greater support. This can be true in the short-run when the direct investment in effect takes place by the flow of capital goods in the form of new equipment to establish a branch plant, a wholly-owned subsidiary, or even a joint venture. Capital equipment exports could well continue in the longer-run as well, as the foreign operation expands.

Other types of export linkages are possible. For example, Cominco has a 45 per cent ownership interest* in Mitsubishi Cominco Smelting Company Ltd. of Japan** which purchases lead concentrates from the Pine Point Mines Ltd. in the Northwest Territories (69 per cent owned by Cominco).

CDIA in underdeveloped countries can also be advantageous to Canada from the point of view of securing reliable and continuing supplies of an essential raw material. (A "cost" from the balance of payments point of view could be the generation of imports.) Alcan, for example, has direct investment in bauxite mines in Guyana, Jamaica, and the Malay Peninsula, and without such sources production, employment and income in Canada could be adversely affected. Against the economic benefits must be put the economic costs, some of which are the use of savings in Canada for investment overseas rather than for investment in Canada and the flow of Canadian entrepreneurial talent overseas. Many economists consider both factors to be relatively scarce factors of production in Canada. There is also the fact that, from the Government revenue point of view, the Government gains less direct revenue from a given amount of investment abroad than it does on the same amount of domestic investment. While a precise measure of the net economic advantage or disadvantage to Canada of a greater flow of CDIA is certainly in order, this report can do little more than raise some of the questions. (For example, what is the economic benefit to Canada of the recent Federal Government policy encouraging Canadian business men to leave Canada for periods in their productive lives to serve in underdeveloped countries?)

There seems little reason to believe that the U.S. Federal Government would look unfavourably at special programs by the Canadian Government to encourage CDIA to the underdeveloped countries. The U.S. Voluntary Program to improve the U.S. balance of payments "seeks to avoid adverse effects on these areas" since the U.S. Government wishes "to encourage American private enterprise to assist in the introduction of modern techniques and to help raise standards of living in these countries".(3) Solely on the basis of this

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* Assuming for the sake of argument that DBS classifies this as CDIA.

** Assuming for the sake of argument that Japan is an underdeveloped country.

its Voluntary Program) would have to be designed.* (This last statement assumes the acceptance of the assumption that the flow of dollars and goods and services from Canada to the underdeveloped countries is a valid and necessary means, although not the only means, of assisting the underdeveloped countries.)

While it can be argued that an opportunity cost of much greater CDIA to underdeveloped countries (as well as to the developed countries) is a greater non-resident ownership and control of certain sectors of the Canadian economy, it seems doubtful that in quantitative terms it would be very great: An annual increment of $120 million in CDIA in 1970 is large relative to the present increment but it is not large in terms of total investment in Canada and would not have a significant net opportunity cost in terms of non-resident ownership and control of certain sectors of the Canadian economy. Whether or not the greater internationalization of Canada's investment resources via a greater and more geographically balance distribution of CDIA would contribute to, or be associated with (or simply occur at the same time) a greater internationalization of non-resident ownership and control of the Canadian economy remains an open and yet unanswered question.

The economic and political costs and benefits to Canada of its present largely "neutral" policy also remains an open and yet unanswered question. Similarly with the question of an explicitly "negative" policy. These are largely the reverse side of the costs and benefits of an explicitly "positive" policy.

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* For example, The Royal Commission on Taxation recommends "tax-sparing" treaties with the underdeveloped countries on a country-by-country basis.

Footnotes

1. Report of the Royal Commission on Taxation, Queen's Printer, Ottawa, Vol. 4, p.510.

2. Ibid, p.511

3. Text of Secretary Connor's Letter to 400 Chief Executives of Companies Not Previously Reporting Under the Voluntary Program to Improve the U.S. Balance of Payments, Department of Commerce, Washington, D.C. (U.S.), January 14, 1966, pp. 2 and 3.

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CHAPTER 12: PART C

Some Brief Comments on Some Possible Implications of the Royal Commission on Taxation for CDIA

I

Some of the recommendations of the Royal Commission on Taxation have a direct bearing on CDIA. As the following brief quotations and comments will illustrate, the extent (if not the direction) of the influence of the Commission's recommendations on the accumulation in, and outflow of, CDIA is very much an open question. The Commission itself recognizes that "because little is known with certainty of the consequences of adopting alternative policies", the formulation of policy on taxation of international income is most difficult.

II

The Commission recommends the following tax changes.

> The present exemption from tax of certain foreign dividends received by a resident corporation which is provided by Section 28(1)(d) (of the Income Tax Act) should be withdrawn. Dividends received from foreign direct investment should be grossed-up at an arbitrary rate of 30 per cent and a foreign tax credit of the same amount allowed. If the dividend was received by a resident individual, then the applicable Canadian tax on the grossed-up amount would be payable at the time of receipt. However, if the dividend was received by a resident corporation, no tax would be payable until the income was in turn distributed or allocated, at which time a withholding tax of 20 per cent of the grossed-up amount should be collected so that the resident shareholders would be entitled to a tax credit of 50 per cent of the grossed-up distribution (the original 30 per cent foreign tax credit plus the additional 20 per cent withheld).(1)

The Commission notes that "tax sparing" could be authorized by treaty on a country-by-country basis to offset an unfortunate side effect of the proposal, that is, the neutralization of such tax concessions granted by underdeveloped countries.(2)

The Commission believes that Canada's international tax provisions "that would permanently impede capital movements in either direction should be avoided." It notes that "capital movements may be impeded during the adjustment period following the introduction of our integration proposals, but it is not put forward as a measure intended to produce a permanent effect of this kind".(3)

III

Professor Dan Thropp Smith makes the following observations about the impact of the Commission's recommendations (including the greater absolute incentives to residents to invest in Canada as well as the recommendations relating to international taxation) on CDIA in particular.

> Many of the recommendations in the Report appear....to be designed to make Canada economically more self-contained. Canadian capital would tend to be kept at home by a combination of inducements to domestic investment and penalties against foreign investment.....(A) fundamental penalty against foreign investment is the 20 per cent tax imposed as the income from a foreign subsidiary is distributed by a Canadian parent corporation to its Canadian shareholders. This tax would apply even if a 50 per cent

> tax had been paid by the foreign subsidiary. There is thus an absolute discrimination against income earned by Canadian corporations through foreign subsidiaries whenever the foreign tax rate exceeds 30 per cent. This tax differential would be likely to be sufficient to make Canada an inappropriate home country for international companies.(4)

Professor Smith also notes that, in his opinion:

> The failure to give full credit for the foreign taxes paid where income is earned would be contrary to what has come to be established international practice. Generally, only those countries which limit their domestic tax on income from foreign direct investment to a very nominal rate, such as France, or those countries giving full exemption, such as the Netherlands, fail to give full credit up to the level of the domestic tax. As the Report so properly notes, this failure by Canada to follow international rules would be likely to be resented by the governments of the countries where the income was earned. They would be justified in retaliating by failing to give full credit for Canadian taxes. If other countries did retaliate by following the Canadian example, as the Report further recognizes, Canada would become unattractive for foreign direct investment, with adverse results on Canada's balance of payments and economic growth.(5)

Finally he notes that:

> The proposal that tax-sparing could be recognized by treaty would put a heavy task on treaty negotiators; until new treaties were in force, Canadian companies would be unwelcome guests in foreign countries offering tax concessions and would in fact probably be discriminated against by foreign governments. Under existing laws in all other countries, a tax concession to a subsidiary of a foreign parent at least benefits the subsidiary so long as the income is not withdrawn. Under the proposed procedure, the tax foregone up to 30 per cent would be immediately picked up by the Canadian government.(6)

Another economist, Professor Robert W. Thompson makes the comment that:

> The Report adopts the very reasonable position that Canadian residents who invest in equities at home should receive no less favourable tax treatment than if they had invested abroad. In both cases there should be integration, for purposes of determining the tax base, of individual income from personal and corporate sources with a tax credit being allowed, up to a maximum of 30 per cent, for taxes paid to another government. The net effect of the Commission's proposals would be, it is suggested, to make investment by Canadians in Canadian equities more attractive compared with investment in foreign equities than is the case under existing tax laws. And, to the extent that more Canadian capital was invested at home, the need for foreign capital would be reduced.(7)

IV

The purpose of the above quotations was simply to point out some of the possible implications of the Commission's recommendations for CDIA. Hopefully, the final report of August 31st will contain some detailed analysis of those implications.

Footnotes

1. Report of the Royal Commission on Taxation, Vol. 4, Ottawa: Queen's Printer, 1967, p.486.

2. Ibid, p.532.

3. Ibid, p.484.

4. Smith, D., "Economic and International Aspects of the Report of The Royal Commission on Taxation", an Address to the 96th Annual General Meeting of The Canadian Manufacturers' Association, Toronto, May 29, 1967.

5. Ibid

6. Ibid

7. Thompson, R., "Foreign Investment", in The Canadian Forum, Vol. XLVII, No. 556, Toronto, p.38.

CHAPTER 12: PART D

The Implications of the Kennedy Tariff Round for CDIA

Other things being equal, lower tariffs will tend to make exports more competitive with new CDIA.

CHAPTER 13

Concluding Comments

I

It has been recognized from the outset, and repeated throughout this report, that little more could be done in a period of two and a half months than to gather together some of the existing and available information on Canadian direct investment abroad. However, it was also recognized that the information gathered should be ordered and analysed wherever possible in such a way so as not only to throw some light on the specific question under study, i.e., CDIA, but also to place it in context of the overall study on the structure of Canadian industry, of which this is but one part.

II

Accordingly, an attempt has been made to accomplish this goal in three ways. In the first instance information on the extent and nature of CDIA has been collected in the form of aggregate statistics. Secondly, acknowledging the fact that the statistics are of limited value in themselves, an attempt has been made to analyse them. This analysis should be a critical section of this report not so much for the answers it suggests but rather for the attempt to grapple with some of the conceptual problems that must be resolved, if the statistics are to be analysed in any meaningful way. Finally, in order to further clarify the statistical data as well as to concretize the conceptual problems, profiles on 18 of the original 33 Canadian firms were drawn up in such a manner as to emphasize their direct investment character.

III

Limitations resulting from the quality of the information provided by the public sources consulted have hampered the integration of the macro and micro data.

IV

It is obvious that a great deal more research of a long-run nature is required on CDIA.